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Susanne Baer, PhD*

EQUALITY ADDS QUALITY: ON UPGRADING HIGHER EDUCATION AND RESEARCH IN THE FIELD OF LAW

Much has been attempted, and many projects are still underway aimed at achieving equality in higher education and research. Today, the key argument to demand and support the integration of gender in academia is that equality is indeed about the quality on which academic work is supposed to be based. Although more or less national political, social and cultural contexts matter as much as academic environments, regarding higher education and research, the integration of gender into the field of law seems particularly interesting. Faculties of law enjoy a certain standing and status, are closely connected to power and politics, and are likely to feature resistance to equality efforts, both in the law itself and in the curriculum and research agenda. However, a multidimensional, intersectional gender analysis helps to reframe cases and doctrines, rulings and regulations far beyond the law that evidently affects women, which the headscarf controversies illustrate. In addition to gender competence, team diversity is a procedural device for success, and non-discrimination is a key requirement when diversity is meant to work. After all, such efforts – to expose bias and educate about gender in an academic field, to insist and integrate it continuously, and to not only demand but also do it – produce quality. Thus, gender equality is crucial for the achievement of the best possible results in higher education and research.

Key words: *Quality of research*. – *Gender equality*. – *Legal studies*. – *Intersectionality*. – *Headscarf*.

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1. INTRODUCTION

Efforts to achieve gender equality in higher education and research are not new, and some have had impressive results. However, such efforts are still needed,[1] because equality in higher education and research is, simply, a matter of quality. This is a broad claim since, after all, quality is what drives the field; sometimes it is called merit, sometimes excellence, and if equality is a key factor in its achievement, there is then an inherent reason to act.[2] And although to understand what needs to be done we must constantly assess the changing state of affairs as well as evaluate our own efforts to do better, there is no reason to wait. In the past, actors responsible for quality in science have put the quest for equality in a docket, to another subcommittee, in one more study, or on someone else's agenda. In 2017, this is no longer adequate, if it ever was. Today, there are smart ways to work towards gender equality in higher education and research, with sound assessments of results and effects, and there is abundant expertise. Unquestionably, there is never enough research on anything. Yet there is already enough to upgrade higher education and research regarding gender equality, to build upon and get going. This contribution shares some of the observations of gender equality efforts, primarily in Germany, to demonstrate why gender equality in higher education and research really matters, and why it must therefore be part of the mainstream, using the somewhat paradigmatic example of law.

2. SIMILARITIES AND DIFFERENCES IN CONTEXT

Certainly, both the state of affairs in higher education and research, as well as the toolbox to change it, vary depending on context. Both national and cultural settings matter, as do institutional arrangements and disciplinary traditions, practices, and status. Therefore, the situation in Serbia certainly differs from the past and future of gender equality in academia in Germany, or in other countries.[3] However, comparative observations do help. In addition, higher education and research have, in most

[1] S. Klein *et al*. (eds.), *Handbook for achieving gender equity through education*, Routledge, 2014 (1st ed. 1985); L. Frehill *et al.* (eds.), *Advancing Women in Science*, Springer, 2015; E. Blome *et al.* (eds.), *Handbuch zur Gleichstellungspolitik an Hochschulen: Von der Frauenförderung zum Diversity Management?*, Springer, 2014.

[2] This is the rationale of the German Research Foundation's (DFG) "Research Oriented Standards in Gender Equality", to be found, with evaluation reports and a tool box for best practice examples, *www.dfg.de/en/research_funding/principles_dfg_funding/equal_opportunities/research_oriented/*, last visited 12 September 2017.

[3] On the Nordic countries, see: L. Husu, Advancing Gender Equality in Nordic Academia: Political will and Persistent Paradoxes, XVIII World Congress of Sociology, 2014, *https://www.researchgate.net/publication/268085220_Advancing_Gender_Equali-*

fields, already moved across national borders, which enlarges the commonalities that we share. In fact, thinking across borders is the calling for law and thus for legal studies in the future, taking stock of today's embeddedness of national law in transnational and international legal pluralism. This does not affect only the law and legal studies, but all of academia. Therefore, a European as well as a global understanding of efforts to achieve gender equality in higher education and research is both relevant and necessary.

Similarities and differences between countries and contexts of the state of higher education and of gender equality as a social fact, a cultural phenomenon, an economic factor, a political topic and, not least, a legal issue, do matter. In particular, gendered inequalities in higher education and research may be perceived as a setback in former socialist societies, where more women had access to paid work than in Western European countries, including work at universities, as is the case in some South European countries. At the same time, such presence may coincide with a history that lacks academic freedom and features a hegemonic political ideology that informs disciplines, and particularly the field of law. Depending on various factors, higher education and research may then come with challenges to or even suppression of truly critical work, or a problematic tolerance of other injustices, e.g. excluding "the other", something that has also varied with context. It seems important to understand this.

And there is lot to consider. Institutionally, higher education may or may not carry prestige, either for institutions or persons. Legally, higher education and research may be more or less public and formed by law, or private and regulated in non-democratic ways. All of this also impacts gender equality, and thus the inequality in higher education and research.

Again, in a world that is more closely connected than ever, and with research becoming more transnational by the minute, even in formerly national fields such as law, commonalities across borders and political systems tend to increase. When it comes to higher education and research, formerly socialist as well as older capitalist countries are both confronted with a turn to efficient governance, monetary and metric standards, and witness market logic applied to science and research. Some gain, some loose. Indeed, a greater entrepreneurial spirit, more transparency, or more competition may support gender equality, but it may also hurt such efforts. With the field in flux, it seems more important than ever to exchange ideas and experience, to collaborate towards a shared commitment: excellent research that informs the best practices for our future. One factor in achieving this is, again, gender equality.

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ty_in_Nordic_Academia_Political_Will_and_Persistent_Paradoxes, last visited 12 September 2017.

3. ACADEMIC DISCIPLINES: THE EXAMPLE OF LAW

Certainly, gender equality in higher education and research does differ in relation to different academic disciplines. The field of law, as legal research and teaching law, may be particularly interesting in order to understand gender inequality in this context. In law, gender equality indeed matters in specific ways, and for specific reasons.[4]

First, the faculty of law is, traditionally,[5] a proud faculty in most universities in the world, with a long and strong tradition. Often, you find law schools in prestigious buildings, law professors who are paid more than others and who enjoy social and political capital, as part of their habitus,[6]as well as alumni in powerful positions. Regarding gender equality, this makes the faculty of law both an important place to induce change, and often, an institution not seriously challenged and thus particularly slow.

Secondly, the field of law, and thus law faculties or law departments as well as legal academics, are closely linked to power and politics. They do not only study a key instrument of politics and power, but legal research typically engages that instrument in the affirmative, providing doctrine, which is collaboration.[7] In fact, the more legal studies are driven by work on doctrine to systematize legislation and jurisprudence as well as administrative routine, the more relevant legal studies are to the actual functioning of the world. Even in deliberately skeptical academic environments, faculties of law educate and law schools train a large set of influential people who eventually occupy influential positions. Thus, one

[4] S. Berghahn, "Wozu Gender-Aspekte in Lehre und Forschung von Rechtsfächern?–Über blinde Flecken und verkannte Professionalisierungschancen", *Kompetenzen für zeitgemäßes Public Management* (Hrsg. D. Luck-Schneider, E. Kraatz), Nomos, 2014, 69–90.

[5] This goes back to philosopher Immanuel Kant, *Der Streit der Fakultäten, Anthropologie in pragmatischer Einsicht*, Berlin – New York 1907, 2000; in English "The Conflict of the Faculties/Der Streit der Fakultäten" (trans. M. J. Gregor), New York 1979. A critical view on the formation of disciplines is provided by M. Foucault, *Discipline and Punish: The Birth of the Prison*, Vintage Books, 1977.

[6] Pierre Bourdieu's concept of "habitus" by captures the sources of the standing of a person and has been applied to the academy, D. Reay, "Cultural capitalists and academic habitus: Classed and gendered labour in UK higher education", *Women's Studies Int'l Forum* 27/2004, 31–39.

[7] This is why the British sociologist Carol Smart warned feminists against the "siren call" of law in *Feminism and the Power of Law*, Routledge, 1989. Famously, U. S. Black lesbian activist, scholar and poet Audre Lorde coined the saying that "The master's tool will never dismantle the master's house." The text is available online. My interpretation is to call on us to modify the tool. See: A. Lorde, "The Master's Tool Will Never Dismantle the Master's House", *The Bridge Called My Back: Writings of Radical Women of Color* (eds. Ch. Moraga, G. Anzaldua), Kitchen Table Press, New York 1983, 94–101, *http://bixby.ucla.edu/journal_club/Lorde_s2.pdf*, last visited 12 September 2017.

might expect a correlation between equality politics in society, addressing power, and the people who engage the instrument on their own as academics.

Thirdly, the field of law and legal studies is highly canonized. This accounts for the stability of the curriculum, yet it is also an impediment to change, a kind of structural conservatism. The canon also informs and is perpetuated by the large, or at least well-organized and implemented, consensus on standards. While other academic fields have a faster changing flow, law stays rather steady. In addition, law school curricula that define study material and degree requirements, thus converted into professional standards, are often at least partially defined by government. This may contribute to structural conservatism, yet it may also make legal education susceptible to the influence of current events. Accepting the risk that defenders of the status quo resist "outside intervention",[8] there is certainly an opportunity for policy makers and funders of higher education and research to in fact demand equality, in order to upgrade quality.

Fourthly, the field of law is evidently relevant to us all, which is why people both in and outside academia tend to be concerned. Regarding the relevance of academic work, law fares much better than what are sometimes called "orchid fields", a label for academic fields that are not even recognized as disciplines, quick to be sacrificed when budgets suffer, etc. (although orchids are also notably beautiful and rare). By comparison, legal studies and faculties of law have stability and strength resulting from their evident relevance to all. However, this does not seem to have an automatic effect on efforts to achieve gender equality. One would expect the field, and thus faculties of law, to quickly adapt to changes in society, and even be champions of social progress, based on the task to train lawyers and based on the foundational engagement with the concept and practices of justice. Yet, all too often, the opposite seems to be the case, with legal studies and law schools being champions of conservatism, widespread resistance, and thus ultimately justice limited to the few. A similarly inherent conservatism may be found in similarly strong, organized, proud and evidently relevant fields such as sciences, technology, engineering and mathematics (STEM), as well as medicine. This is why it seems highly plausible when studies show that women, and others who are traditionally "othered" in the field, work on the fringes of the academic spectrum. Yet, this is not all there is to the story. In fact, it underscores the claim that equality drives (real) quality, since studies also show that the fringe often drives innovation,[9] a facet of excellent education

[8] For men's strategies regarding quests for gender equality, see J. Hearn, "Men and Gender Equality – Resistance, Responsibilities and Reaching Out", Örebro, Sweden 2001, *https://www.atria.nl/epublications/2001/Men_and_gender_equality.pdf*, last visited 12 September 2017.

[9] L. Schiebinger, Gendered Innovations in Science and Engineering, 2008, *https://genderedinnovations.stanford.edu/*, last visited 12 September 2017.

and research. When academic institutions commit themselves to equality, such innovation and its drivers will be properly recognized.

Overall, law offers insights into an old and well-established field, between the humanities and social sciences, entangled with technology and medicine, a powerful field, close to social needs and the politics required to address them, a field in which higher education and research are self-evidently relevant for all its participants. To properly address gender equality in higher education and research, the field is also bound by an understanding of the rules of the game, which in a truly merit-based system relies on fairness, non-biased judgment, and freedom from discrimination. As such, law may serve as both an object to be studied, and as a field that possibly offers the answer to what needs to be done. In fact, the law itself requires equality in education.[10] There is also a crucial difference between an interesting discussion on the one hand, and a decision to implement change on the other. Confronting an issue through the prism of the law[11] thus often sheds brighter light on the challenges that we face.

4. EASY CASES

Imagine you are a judge willing to render good judgments, or a legislator drafting good laws, or an administrator applying the law, or a practicing lawyer committed to winning a case, or a law professor teaching, or a student trying to get it right; this means you need to be excellent at law, to be able to either apply or draft it. Also, imagine you are not on your own, but in a team, with colleagues, with members of your party or cabinet, of your faculty or study group, or on a judicial panel of a supreme or constitutional court. How do you go about being good, winning, teaching well, passing the exam?

There are many examples one could use to illustrate the strategies employed for the accomplishment of this task. In fact, there are many cases that seem easy and straightforward, which profit highly from additional perspectives, namely, by contributing the sophisticated understanding of gender. As an example, many seem to have a clear idea of the

[10] Obligations come from local and state as well as national and international law, with the minimum guarantees of equal rights to access and protection against discrimination, and often more elaborate legal mechanisms to address sex equality as well as other situations typically subject to disadvantage.

[11] To apply the law means to not apply your normative ideas about the world. Certainly, there is no such thing as "pure" or "clean" legal thinking, suggesting complete neutrality, full objectivity and the like. After all, it is human beings who apply the law. Application thus is also the translation of an abstract idea into a proper response to a specific set of facts, which involves interpretation, a necessarily subjective element. Therefore, targeting bias is particularly relevant to the field.

problem of domestic violence.[12] However, the introduction of gender analysis to its understanding in the law upgrades our understanding significantly. In legal gender studies "violence" is a complex concept dependent on insufficiently elaborated, stereotypical, and largely biblical ideas of direct physical harm. Even better, violence is defined as a specific activity inducing different types of harm. Also, if the gendered nature of *home* and *privacy* are taken into account, our understanding of *domestic* advances to a nuanced analysis of a physical space, but also of a cultural site as well as a decisional mode. The point is that adding gender analysis upgrades the quality of the discussion.

One may want to consider *sexual harassment* as another example. Again, it will seem to many that we know what this is about. However, a gender analysis will allow us to understand the power relations in different workplaces, and regarding a variety of markers of inequality, namely sex, race, age, ability, as well as the implications of class. The point is that even in cases where it seems that gender is already recognized, a gender analysis, informed by the current work in the gender studies, upgrades our abilities to address the world properly.

Less obvious than these two cases, one may also consider *contracts*. Again, many have a quick take on the issue, and lawyers will quickly name the relevant aspects at stake. Again, gender adds to our understanding. Better understanding is based on the work linked to the gendered nature of our definition of the legal subject, of autonomy and free will, of consent, including the intersectional nature of inequalities that modify gender in the world. The point is, once more, that gender is a relevant component of cases, problems or issues beyond those ordinarily discussed. Thus, a gender analysis certainly also upgrades our notions of "torts", but will also qualify our understanding of building and planning regulations, or of the regulation of infrastructure, such as telecommunication, etc. Despite the fact that gender matters tremendously to most people, its relevance has not yet been fully integrated to allow for a more informed discussion.

4.1. Knowledge and Diversity

To quickly illustrate the argument that equality in higher education and research, and in law, produces better quality, you may also take a look at the telling case of the headscarf.[13] This garment has surfaced as an item of contention in many countries, and many will immediately have

[12] N. Petrušić, S. Konstantinović-Vilić, *Porodičnopravna zaštita od nasilja u porodici u pravosudnoj praksi Srbije*, Beograd – Niš 2010.

[13] A more elaborate discussion in S. Baer, "Intersectional discrimination and fundamental rights in Germany", *Sociologia del diritto* 2/2016, 65–86.

an idea of what is the essence of the problem. In Europe people tend to think of Islam in secular schools, be it as pupil or teachers of Muslim belief, or be it as a subject of studies. Often the headscarf case occupies an almost paradigmatic position, in which conflicting perspectives on religion, education and the public, but also women, sexual equality, and proper dress, come to the fore. These are not limited to but often culminate in primary schools: girls as pupils, women as teachers and social workers all have been expelled for refusing to remove their headscarves. The item is worn to cover hair for religious reasons, the religion in question being Islam.[14] However, it is even more complicated than that, and it matters, in law, whether we consider additional aspects or not.

Imagine, then, to be called on to argue, or decide, or teach, or "solve" in your exam one of the paradigmatic cases of Europe today: a headscarf case. Imagine to be called upon, as a lawyer or legislator, a judge or professor or student, to even "solve" the headscarf case. This may not seem overly difficult, because it is a well-known controversy around the globe, both in courts and legislatures as well as in politics, including politics beyond parties, i.e. in social and civil rights movements. How do you frame what matters? How do you know? And what makes your decision, lecture or test especially good, even excellent?

In our example, imagine "the case" is the request of a primary school teacher to work with her hair covered (not to be confused with covering the face), calling into question the decision of the school principal, the Minister of Education, and the legislature, not to tolerate that kind of religious display, to safeguard the order of the school, and secular education. What is this case about?

To many, the headscarf case is about religious freedom, first and foremost. And indeed, it is necessary to understand the nature of religion, and the place of religion in a society, including its official legal status that could range from *laicité* to less or more state-church-cooperation, to religious states. However, if a case is framed like this in law, the spectrum of relevant rights and principles taken into account is too limited.

4.2. A Multidimensional Gender Analysis

Indeed, a gender analysis is beneficial, which compels us here to bring gender into the mainstream of legal analysis. As a first step, it is not just any teacher that is called to leave the school, but a woman. Acknowledging this, we need to take into account the history of women gaining access to professions, and a prohibition of a particular item of clothing as a classic device to disenfranchise women. In law, it is then not only the

[14] For a comparative account, see: N. Dorsen, *et al*., *Comparative Constitutionalism*, West Academic, 2016[3], chapter on religious freedom, the clash.

right to religious freedom that matters, but also the right to sex or gender equality that is at stake. Yet this recognition of the physical presence of people as women or men is only the first step, while a comprehensive gender analysis calls for more.

As a second step in our effort to do justice to the world, it helps to consider the gendered status and nature of the job and schools as institutions. Primary schools are often staffed by women (but have male directors), while later schooling is done much more by men. This may be based on the different expectations of what is taught, namely basics and manners versus knowledge and mind. In addition, schools are place where the citizen is formed, similar to the family, which is much more foundational to society than theories of the state and democracy have long been willing to acknowledge.[15] In law, this may inform different notions of a state interest in a particular school practice, starting with what is in Germany labeled as "peace at school" (*Schulfrieden*) and has rather authoritarian roots, but nevertheless opens us to greater comprehension. With a gender analysis, we are able to understand the professional tasks and challenges of teachers, including the gender and sexual politics at play, which may inform a distinction between rational expectations of professionalism and unfair presumptions, directed, in this case at a woman covering her hair, which are in fact not relevant to the task.

Additionally, a gender analysis calls on us to understand gender in the context of still other markers of inequality and discrimination.[16] With an enormous impact on gender studies, Black women in the U.S. have used the concept of intersectionality, which is now also discussed as multidimensionality of equality.[17] It recognizes that no one may be reduced to one characteristic or social structure alone, but must be understood in a much more realistic manner, situated in multiple dimensions. This has an immediate appeal to anyone who has ever addressed all the aspects that matter to who we are in the world and how the various relevant as-

[15] D. Vujadinovic, "Family Structures and Civil Society Perspectives in Present-Day Serbia", *The Golden Chain: Family, Civil Society, and the State* (eds. P. Ginsbourg *et al*.), Berghahn Books, 2011. On the Anglo-Saxon tradition, see S. Moller Okin, *Justice, Gender and the Family*, Basic Books, 1989.

[16] A. Scherr, A. El-Mafaalani, G. Yüksel (eds.), *Handbuch Diskriminierung*, Springer, 2017.

[17] A more recent account is given by S. Cho, K. Crenshaw, L. McCall, "Toward a Field of Intersectionality Studies: Theory, Applications, and Praxis", *Signs: Journal of Women in Culture and Society* 38/2013, 785–810; D. Schiek, V. Chege (eds.), *European Union Non-Discrimination Law: Comparative Perspectives on Multidimensional Equality Law*, Routledge, 2009; B. Bello, "Multiple Discrimination Between the EU Agenda and Civic Engagement: The Long Road of Intersectional Perspective", *Women's Studies* 13/2010, 22; on challenges, see: S. Baer, J. Keim, L. Nowottnick, "Intersectionality in Gender Training", 2009, *http://www.quing.eu/files/WHY/baer_keim_nowottnick.pdf*, last visited 12 September 2017.

pects change across contexts. Namely, men tend to acknowledge themselves as men only in particular settings, and reluctantly if it does not serve to perpetuate the hegemonic version of masculinity, while women are often reduced to being nothing but women, with a focus on traditional sexist femininity. Conversely, age is constantly referred to, yet aging is taken very differently, again, highly contextually. In the headscarf case, adding gender as an intersectional category to the analysis allows us to again upgrade our understanding of "the case". We must acknowledge that religion is not just a liberty interest but also a marker of discrimination. Furthermore, the rights of Muslim women are often connected to a specific migration background, i.e. to ethnic identity, and thus to more than only one such label. Also, class may be relevant to our understanding of the case, in that the teaching profession is, in many contexts, a gateway to climbing the social ladder, to emancipation via social mobility. Again, the point is that equality adds to quality.

Thus, the "headscarf case" is certainly about varieties of religious pluralism that challenge established notions of what seemed normal, including the way people dress and cover, or not cover, the head, and often, but not always, hair. Conflicts around the headscarf focus on a particular type of dress as a religious item, and not as a means, such as hygiene or for protection while working, cultural tradition or practicality. But the case is just as much about gender and other markers of inequality. To do justice to the case, as a lawyer or legislator, a judge, professor or student, it is a necessity to take that into account.

5. TEAM DIVERSITY AND NON-DISCRIMINATION

As a gender-competent analysis of one case illustrates, to do better in law and in other fields of higher education and research, it is necessary to expand one's knowledge. Additionally, this is extremely helpful, and in fact a necessary procedural device for critical analysis to work in a team. Despite the idea of a lone genius at his desk, teamwork forces efforts in the humanities and social sciences as much as in STEM fields to work from multiple perspectives. In addition to its heuristic value, the emphasis on teamwork not least discards the ideal, which was a privileged and usually male vision of the genius on his own, save for his trusty sidekick, who takes care of his personal life and the tedious work of less challenging research.

To illustrate the point, we turn to collegiate courts in which judges sit in panels, or chambers, or senates. They are called to the bench as individuals, yet once there, they are called upon to share their individual approach with all others, and argue their solution; at no point do they

decide on their own. There is a long tradition and widely accepted value of such teamwork in most legal systems. Thus, diversity as an aspect of quality should come naturally to the law, and also to law schools and faculties of law. To date, socially meaningful diversity is still more wish than reality or even goal in legal institutions, including faculties of law and departments of legal studies.[18] Seemingly, a desire for closure dominates. Yet, as much as our international legal thinking and practice profit from exchange, the quality of one's work in general will profit from more voices to be heard in the search. Even in courts, the aspects considered as productively diverse must be expanded.[19]

Diversity is not just the positive side of non-discrimination. Let us be clear that diversity is a productive procedural device for the care of justice. Nevertheless, first and foremost, non-discrimination is the rule. In fact, there is no option to ever achieve meaningful diversity if sexism, racism and other practices of discrimination are not addressed adequately, which means swiftly and resolutely. If discrimination persists, and particularly if it is taboo ("that does not happen here"), there will be no team diversity to cherish.[20] Discrimination in whatever form simply cannot be tolerated in legal education, nor in legal practice, and this still needs to be exposed, adequately addressed, and unambiguously rejected.[21] The absence of discrimination consists both of a refusal to engage in it as either actor or bystander, as well as of the clear condemnation if it happens from

[18] V. Eickhoff, L. Schmitt, "Herausforderungen hochschulischer Diversity-Politik", *Managing Diversity* (eds. K. Fereidooni, A. P. Zeoli), Springer, 2016, 199–228. Also see: N. Dowd, K. B. Nunn, J. E. Pendergast, "Diversity Matters: Race, Gender, and Ethnicity in Legal Education", *U. Florida JL & Pub. Policy* 15/2003, 11.

[19] Not all collegiate courts foster the ideal of diversity on the bench, but some constitutional and many international courts deliberately integrate diverse experience and perspectives into their design. According to German political practice, justices for the Constitutional Court are nominated by political parties in relation to their long-term success in national elections, yet have to be voted in, according to law, by a 2/3 majority. They thus require the support of all relevant political factions. In addition, the law requires at least 3 career judges per Senate of 8, and asks for fully qualified lawyers of a minimum age. Recently, proposals for a legal obligation to achieve gender parity on the bench has failed, yet a record gender quota has been achieved in 2016 (7 women, 9 men; plus age, sexual orientation, professional background, etc.).

[20] When teams start getting more diverse, there will always be a "first", i.e. first woman, first disabled, first non-heterosexual, first younger/older, etc.; Sharing experience helps to ease this start. Ulrike Schultz, a longtime champion of gender equality in the law, produced an online database of interviews with female law professors in Germany, to circulate stories, *http://www.fernuni-hagen.de/jurpro/*, last visited 12 September 2017. See also: U. Schultz, G. Shaw (eds.), *Women in the Legal Profession*, Hart Publishing 2003; U. Schultz, G. Shaw (eds.), *Gender and Judging*, Oñati International Series in Law and Society, Hart Publishing, 2013.

[21] L. Chebout, S. Gather, D-S. Valentiner, "Sexismus in der juristischen Ausbildung. Ein Aufschrei dreier Nachwuchsjuristinnen", *Zeitschrift des Deutschen Juristinnenbundes* 19/2016, 190–193.

colleagues, peers, as well as the institution. As such, it is a necessary condition for diversity to strive.

When it comes to diversity, in the sense of a meaningful presence of multiple perspectives, the courts seem to be a place where this clearly matters. To again use the example of the headscarf, it seems rather obvious that when a court is called upon to address the issue, different judges with different perspectives on life and a different set of personal first-hand experience, as well as trained in a variety of specialist and professional expertise, will also approach legal issues in different ways. In fact, it seems clear that such predispositions do frame the take of the case, and eventually do also inform the ruling. To illustrate, someone close to the school as an institution, be it via one's children or a family member who is teacher, may think about today's challenges of keeping "peace in schools" first. Someone close to discrimination, however, whether via one's own or someone else's experience as "different", may consider that meaningful equality is more important. Ultimately, a person with strong religious views may understand the case to be about religious freedom only. The argument for diversity is thus not that one perspective is better than the other, rather, the argument is that diversity in a team allows it to share perspectives, and thus enriches the consensus that is eventually achieved. Often the focus is on professional diversity (in international settings on national diversity), yet there are also strong arguments made for gender and other types of diversity, be it on the bench, in a law firm, or on either side of the lectern at law schools.

6. QUALITY

As such, the key argument in favor of gender in the higher education of law and legal research is that equality improves quality. Both an intersectional or multidimensional gender analysis as well as an arrangement that acknowledges socially relevant diversity, effectuates more quality in the law itself. Fortunately, after many years of an insistence on "outsider jurisprudence",[22] this can now be stated openly. If one is willing to learn and understand, there are many more examples that illustrate that gender matters in and to law.[23] This reaches far beyond the classic

[22] M. Matsuda, "Public Response to Racist Speech: Considering the Victim's Story", *Michigan L Rev* 87/1989, 2320–2381; F. Valdes, "Outsider Jurisprudence, Critical Pedagogy and Social Justice Activism: Marking the Stirrings of Critical Legal Education", *Asian LJ* 10/2003, 65.

[23] A short "walk" through the legal fields and their gender dimension in: S. Baer, "Justitia ohne Augenbinde? Zur Kategorie Geschlecht in der Rechtswissenschaft", *Recht und Geschlecht – zwischen Gleichberechtigung, Gleichstellung und Differenz* (eds. M.

gender-related fields of family law, marriage and relationships law, or law on sexual violence. In fact, there is inspiring work on gender in criminal law,[24] tax law,[25] in land use regulation,[26] "male" practice on the street that may inform police law,[27] health law (particularly regarding providing sufficiently high standards for all[28]), as well as torts,[29] constitutional law,[30] and human rights law.[31] In addition to all this, there is work on the complicated effects of law regarding gender equality, including the ambivalence of quota.[32]All in all, a thorough and nuanced gender analysis upgrades our understanding of the world, and this informs and eventually also changes our understanding and practice of the law.

Koreuber, U. Mage), Nomos, Baden Baden 2004, 19–31. An inspiring Australian approach is R. Graycar, J. Morgan, *The Hidden Gender of Law*, Federation Press, 2002, and R. Graycar, J. Morgan, "On The Hidden Gender of Law: A Public Talk", *Australian Feminist LJ* 41/2015, 29–36.

[24] G. Temme, C. Künzel (Hrsg.), *Hat Strafrecht ein Geschlecht?: zur Deutung und Bedeutung der Kategorie Geschlecht in strafrechtlichen Diskursen vom 18. Jahrhundert bis heute*, Bielefeld, 2010; S. Baer, S. Elsuni, "Feministische Rechtstheorien", *Handbuch Rechtsphilosophie*, Springer, 2017, 270–277.

[25] B. Crawford, A. Infanti, *Feminist Judgments: Rewritten Tax Opinions*, Cambridge University Press, 2017; K. Bartlett, D. Rhode, J. Grossman, *Gender and Law: Theory, Doctrine, Commentary*, Kluwer, 2016; U. Mückenberger, U. Spangenberg, K. Warncke, *Familienförderung und Gender Mainstreaming im Steuerrecht*, Nomos, 2007; U. Spangenberg, M. Wersig (eds.), *Geschlechtergerechtigkeit steuern: Perspektivenwechsel im Steuerrecht*, Nomos, 2013.

[26] N. Menon, Y. Rodgers, A. R. Kennedy, "Land Reform and Welfare in Vietnam: Why Gender of the Land-Rights Holder Matters", *Journal of International Development* 29/2017, 454–472.

[27] A. Filipović, "Resonant masculinities: affective co-production of sound, space, and gender in the everyday life of Belgrade, Serbia", *NORMA* 2017, 1–14.

[28] J. Janevic, J. Jankovic, E. Bradley, "Socioeconomic position, gender, and inequalities in self-rated health between Roma and non-Roma in Serbia", *International Journal of Public Health* 57/2012, 49–55; O. Milovanovic, S. Radevic, M. Jovanovic, "Legal Framework and Retirement Policies in Serbia from 1990 to 2016 – Gendered Perspective", *Frontiers in Public Health* 2016, 4, 208.

[29] A North American classic is: L. Bender, "Teaching Torts as if Gender Matters: Intentional Torts", *Virginia J Soc. Pol'y & L* 2/1994, 115.

[30] H. Irving (ed.), *Constitutions and Gender*, Cheltenham – Northampton 2017; R. Rubio-Marín, W. C. Chang, "Sites of constitutional struggle for women's equality", *Routledge Handbook of Constitutional Law*, Routledge, 2013, 301.

[31] U. Lembke (ed.), *Menschenrechte und Geschlecht*, Nomos 2014; K. Knop (ed.), *Gender and Human Rights*, Oxford University Press, 2004; C. A. MacKinnon, *Are Women Human?*, Belknap Press, 2006.

[32] E. Nacevska, S. Lokar, "The Effectiveness of Gender Quotas in Macedonia, Serbia and Croatia." *Teorija i Praksa* 54(2)/2017, 394; S. Ignjatović, A. Bošković, "Gender Equality in Serbia", in *Gender Equality in a Global Perspective*, Routledge, 2017, 198.

7. STRATEGIES OF CHANGE

What is necessary to achieve the quality embedded in equality in higher education and research? As ever, these are knowledge and non-discrimination, while diversity helps in that a multiplicity of perspectives opens the door to challenge one's own presuppositions and prejudices, and reconsider the framing often taken as normal and given. Now how can this be achieved?

To change the status quo, relevant actors need to be willing to integrate both unbiased knowledge about gender as well as the recognition and appreciation of diversity into higher education and research. It is my impression, again, that this may come with some specific challenges in the field of law, which only reminds us that in higher education and research, disciplinary differences already matter. Luckily, to eliminate the gender bias that still exists, there are gender studies that deliver important data, concepts and analyses from and to many academic fields. Much of it is highly relevant to the law, and may be put to better use by informing law, legal education and research. Interestingly, there are also studies on types, levels and sources of resistance to such efforts now as well,[33] to better deal with these, too. Also, there have already been successful efforts in law and legal studies to learn from, and there are ongoing activities in many contexts to support or join, to eventually achieve the quality we need. However, exposure seems as important as education, and to insist on the necessity to change must be accompanied by efforts to integrate gender into the mainstream, which will thus need to change. Often, change also requires more than its demand, in that one simply has to do it: demonstrate that quality is based on equality.

7.1. Expose and Educate

To achieve gender equality in higher education and research, both by upgrading knowledge and by practicing diversity that in fact allows for and offers a multiplicity of perspectives, it seems necessary first to expose and to educate. Gender equality in higher education and research will not come about without exposing the blind spots of the canon, or elaborating the need to understand more and thus better. There is always a challenge to expose what is considered "normal" and why, both in school and beyond, and to ask for the real substance of any claim to *neutrality*, including the neutrality of law to address such highly charged questions. Also, there is a need to expose the gender dimensions of a conflict that is predominantly registered as religious or otherwise, and, in

[33] E. Lombardo, L. Mergaert, "Gender Mainstreaming and Resistance to Gender Training: A Framework for Studying Implementation", *NORA – Nordic Journal of Feminist and Gender Research* 21/2013, 296–311.

a reflexive turn, to expose how gender is used in specific ways to support political agendas. For example, wearing a headscarf is often portrayed as an expression of sex inequality, which then in turn justifies the prohibition, a claim that might be a nuanced account of the situation at hand or driven by an Islamophobic agenda. Also, every conflict around self-determination, religious or otherwise, confronts us with the task to challenge "normal" understandings of *free will*, and *choice*. Thus, in cases surrounding the issue of the headscarf, it is often argued that women are forced to wear such an oppressive garment, which may be true, but also may be a false attribution of a stereotype. Additionally, the notion of *religion* itself must be questioned to understand which version of belief informs or in fact requires a specific behavior. Similarly, to properly understand conflicts in which *women* fare worse than *men*, in their access to a profession, there is always the question of who exactly we are talking about in that the collectives called women or men do in fact have very little internal coherence, so that the gender label may itself be wrong. However, exposing this is often not welcomed very much.

Exposure may excite people, and be fascinating, yet it also stirs anger and motivates resistance. To make your point regarding the concerns of an outsider, or even from an outsider position, and introduce a formerly excluded and therefore outsider perspective, there is a challenging need to insist, again and again, that it counts, despite laughter, denial, a generous smile, or outright rejection. Sometimes, this is born of ignorance, which can be cured. Yet there is also a strong and often rather intuitive will to defend one's privilege, or the privilege one hopes to enjoy soon.[34] To deal with such resistance, it will often not suffice to expose the blind spots, the lack or distortion of data, the false assumption; rather one must also educate what gender equality offers to higher education and research. Even among very smart people, when it comes to gender, it is not enough to demonstrate that things are biased, and thus false, and that research and teaching should be upgraded with gender analysis. This calls for more systematic efforts of and in education.

For example, in German legal studies there are clear indications that many of the hypotheticals that form the core of the curriculum are biased,[35] yet it still takes educational as well as, last but not least, political efforts to achieve change. In fact, people need to not only see the

[34] A. Shalleck, "Report of the Women and the Law Project: Gender Bias and the Law School Curriculum", *J of Legal Education* 38/1988, 97–99. On masculinity as a key factor in this context, see: J. Hearn, *Men of the World Genders, Globalizations, Transnational Times*, SAGE, 2015.

[35] D-S. Valentiner, *(Geschlechter) Rollenstereotype in juristischen Ausbildungsfällen*, Hamburg 2017; L. Morgenthal, "August Geil und Frieda Lüstlein: der Autor und sein Tätertyp", *Kritische Justiz* 16/1983, 65–68; F. Pabst, V. Slupik, "Das Frauenbild im zivilrechtlichen Schulfall", *Kritische Justiz* 10/1977, 242–256; J. Limbach, "Wie männlich ist

blind spot, but to also learn how to challenge their own assumptions. There is a constant need to study how to systematically address gender in all its dimensions in a given field. In science, workshops have been conducted with scientists to address the gender dimensions of their newest innovation, to educate and enhance research. Not least, bias in grading needs to be exposed,[36] but to remove the bias, institutions need training and lasting mechanisms to maintain the competence as well. Again and again, we need to discuss why it matters to take gender on board, and we need to learn from each other, thus be willing to teach and study how this can be done. In seeking to remove bias and prejudice, teaching law is a prime place to address gender inequality, including its intersectionalities, based on as well as inspiring research – all with the aim of better understanding the world.

7.2. Insist and Integrate

Secondly, to achieve gender equality in higher education and research, at the level of knowledge and of persons, it also seems necessary to insist and integrate gender matters into the field at hand. This may sound very similar to exposure and education. However, the emphasis on insistence highlights the necessity to constantly uphold and renew such efforts. Facing resistance and rejection, collaboration often helps, not necessarily because others know better or more, but because they may divert the aggression that is more dangerous to those inside.

Additionally, the emphasis on integration highlights the need to import gender expertise and gender equality into the mindsets and actions of people. It is this necessity that has motivated the struggle for sex equality to be transformed into gender mainstreaming strategies, to position formerly minor and disregarded concerns into the larger picture, and eventually contribute, hopefully then with a broader base, to the broader task.[37] Additionally, integration makes you, or allows you, to remain part of the team, and it may prevent others from leaving.

To successfully achieve integration, challenging demands often can and must be packed into the larger project of working on the quality of higher education and research, for law schools as well as for other aca-

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die Rechtswissenschaft?", *Wie männlich ist die Wissenschaft?* (Hrsg. K. Hausen, H. Nowotny), Suhrkamp, 1986, 87–107.

[36] E. Towfigh, C. Traxler, A. Glöckner, "Zur Benotung in der Examensvorbereitung und im ersten Examen", *ZDRW* 1/2014, 8–27.

[37] Cf. M. Verloo, "Displacement and Empowerment: Reflections on the Concept and Practice of the Council of Europe Approach to Gender Mainstreaming and Gender Equality", *Social Politics: International Studies in Gender, State & Society* 12/2005, 344–365; UN by H. Charlesworth, "Not Waving but Drowning: Gender Mainstreaming and Human Rights in the United Nations", *Harvard Hum Rights J.* 18/2005, 1.

demic contexts.[38] For example, a commitment to achieve gender equality may be well integrated into a commitment to value diversity, both in teaching and research, as well as among students and visitors, and commitment to a productive study environment may support a smaller class structure, if that shows fairer grading results, which may in turn also support gender equality.[39] To bring about change, such backpacking and mainstreaming do often go hand in hand. Thus, to render a good judgment, to draft a good law, to apply the law well, to win a case, to teach for the future, or to get it right even beyond exams – there is not only the need to insist that an equality perspective be taken into account, but also a necessity to integrate it in context.

Insisting on quality, via equality, thus calls for more than a mere presence of "women, too". To make things last, gender equality as a quality factor needs to be integrated into the larger task at hand, consistent with professional and institutional identities, and thus pride, to deliver the academic quality we need.

7.3. Conclusion – Demand and Do It

Finally, to achieve gender competent knowledge as well as diversity of actors, thus eventually truly better quality in higher education and research, it seems necessary to demand, but also do what you are asking for. Luckily, once again, there are many instances in which simply better academic and educational work has been produced.

It starts with the hypotheticals one uses in the classroom or in exams,[40] or in textbooks. It then influences the methods we use to teach and learn.[41] All of this can in fact be replicated and amended, eventually be made better, in the development of training in law, therefore to do no less than contribute to justice in the world.

Others have developed teaching and training tools to rewrite judgments from a feminist perspective.[42] It teaches students, as well as pro-

[38] F. Bleckmann, "Grundlagen und Themen einer kritischen Rechtsdidaktik", *Kritische Justiz* 49/2016, 305–316; P. Mann, "Dimensions of Justice in 21st Century Legal Practice and Law School Pedagogies", *Charleston L. Rev.* 9/2014, 251.

[39] See studies on US law schools, D. E. Ho, M. G. Kelman, "Does Class Size Affect the Gender gap? A Natural Experiment in Law", *J of Legal Studies* 43/2014, 291–321; see also: D. L. Rhode, "Missing Questions: Feminist Perspectives on Legal Education", *Stanford L. Rev.* 45/1992, 1547.

[40] D. Schweigler exposed the sexism in exam hypotheticals in Bavarian state exams, but also pointed out that administrative law exams have been revised successfully. D. Schweigler "Marginalized in the Name of the Law", *Max Planck Research* 4/2014, 10–14.

[41] C. Dark, "Incorporating Issues of Race, Gender, Class, Sexual Orientation, and Disability into Law School Teaching", *Willamette L. Rev.* 32/1996, 541.

[42] R. Hunter, C. McGlynn, E. Rackley (eds.), *Feminist Judgments: From Theory to Practice,* Hart Publishing 2010; R. Hunter, "The Power of Feminist Judgments?", *Fem-*

fessors, a lot about the challenges of rendering judgment.[43] Yet it also educates the legal community and the judges themselves, tasking them to do better in the future. In law schools, the ability to truly comprehend the cases, to then properly argue or decide, may also be enhanced by storytelling,[44] in that this allows for a more ambivalent account of "facts". There are very practical examples out there of how to achieve what may be labeled as gender competence in law,[45] thus providing more quality in legal education.[46]

To bring about change in a well-established field is a challenge and a promise, a fascinating journey and a daunting task. To carry forth what is relevant to the best solution, to better understand the law, to argue convincingly, and to decide justly, we need to expose bias and educate colleagues and teammates continuously, to make all of us understand what we have not yet thought of or what most have thought of differently, but unfortunately wrongly. Eventually, one also needs to educate the wider public to accept what has been done or is about to happen, in order to be allowed to continue doing it and prevent a roll back. All in all, change requires a flexible shifting between demanding and doing. If possible, simply teaching in a diverse team, acknowledging diversity in the classroom, using a feminist, antiracist etc. analysis of material, as well as design hypotheticals and exams without bias – all this has lasting effects. Talking about the need for equality in higher education and research is certainly worth the effort. Yet in addition to the demand, it seems that doing it will have the most impressive effect.

In short, gender equality in higher education and research calls on those committed to merit, or even excellence, necessarily including fairness and non-discrimination, to expose and educate, insist and integrate, and demand as well as do it. In law, gender equality indeed matters in

inist Legal Studies 20(2)/2012, 135–148; H. Douglas, F. Bartlett, T. Luker, R. Hunter (eds.), *Australian Feminist Judgments: Righting and Rewriting Law*, Hart Publishing 2014; K. M. Stanchi, B. J. Crawford, L. L. Berger (eds.), *Feminist Judgments: Rewritten Opinions of the United States Supreme Court*, Cambridge University Press, 2016; M. Enright, J. McCandless, A. O'Donoghue (eds.), *Northern/Irish Feminist Judgments: Judges' Troubles and the Gendered Politics of Identity*, Hart Publishing 2017. See also: M. Cole (ed.), *Education, Equality and Human Rights: Issues of Gender, 'Race', Sexuality, Disability and Social Class*, Routledge, 2017.

[43] See R. Graycar, "The Gender of Judgments: Some Reflections on 'Bias'", *University of British Columbia Law Review* 32/1998, 1.

[44] N. Levit, "Legal Storytelling: The theory and the Practice – Reflective Writing Across the Curriculum", *J of Legal Writing Institute* 15/2009, 259–283.

[45] D-S. Valentiner, "Genderkompetenz im rechtswissenschaftlichen Studium", *ZDRW* 2/2016, 152–161.

[46] For the US, see: M. Hart, "The More Things Change-Exploring Solutions to Persisting Discrimination in Legal Academia", *Columbia J. Gender & L.*31/2015, 1.

specific ways.[47] There is not only the need to reach gender equality in higher education and research, there is also a lot of knowledge out there to integrate, and many strategies to learn from, to better train people, even in law schools.

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[47] S. Berghahn, 69–90.

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SOME SPECIFIC ISSUES ABOUT ARBITRABILITY IN SPAIN: BACK TO THE PAST?

The object of this paper on arbitrability in the Spanish legal system, is to explore whether the general rule on objective arbitrability, based upon the free disposition of the rights which under the Spanish Arbitration Law translates a general principle pro arbitration and arbitrability, is threatened by doctrinal interpretations, legal rules or recent judicial decisions, where arbitrability has been constrained. This is particularly the case in the field of regulated sectors, where the arbitrability of disputes is quite controversial and complex, and the key institutions meet: arbitration, state justice, and decision-making powers attributed to a regulatory body, in the case of Spain, the National Commission on Markets and Competition (CNMC).

Key words: *Arbitration*. – *Arbitrability*. – *Spain*. – *Regulated sectors*.

1. DOMESTIC AND INTERNATIONAL TRENDS CONCERNING ARBITRABILITY

It is clear that internationally and domestically there is an increasing tendency to increase arbitrability matters,[1] despite the fact that in some domestic legal systems there are always criteria to suggest and challenge whether a matter is arbitrable. Generally, domestic laws consider

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[1] C. Trabuco, M. Francça Gouveia, "A Arbitrabilidade das questões de concorrência no direito portugués: The meeting of the two black arts", *Estudos em homenagem ao Professor Doutor Carlos Ferreira de Almeida*, Almedina 2011, 449; N. Bouza Vida, "La arbitrabilidad de los litigios en la encrucijada de la competencia judicial internacional y de la competencia arbitral", *Revista Española de Derecho Internacional* 2/2000, 373–375.

arbitrability under general rather than exhaustive provisions, frequently changes in the criteria to be applied to arbitrability issues over time.[2] Some national laws provide that all rights or matters that the parties "may freely dispose of"[3] or "property issues"[4] may be subject to arbitration.[5] Also, many statutes link arbitrability with the transaction, and thus the matters that are the subject of a transaction may also be subject to arbitration.[6] These general clauses require significant specification and interpretation in order to assess which of the specific issues that are subject to arbitration are arbitrable. Doctrinal and case law construction is also identified in the few statutes where this issue is not addressed.However, even if considered an ideal moment for arbitrability issues at an international level, State legislators or judges may for different reasons, based on political, economic or legal needs, seek to protect certain interests of individuals or certain eco-

[2] Portuguese law offers an interesting development. Under the repealed Law 31/86 on Arbitration, the criterion of free availability was used, as is done by Spanish law, and it was already understood that the criterion of patrimoniality was broader (D. M. Vicente, *Law of Voluntary Arbitration Annotated*, Almedina– Coimbra, 2017, 30; L. de Lima Pinheiro, *Arbitragem Transnacional. A determinação do estatuto da arbitragem*, Almedina, Coimbra 2005, 105). However, under the current legal provision, where the legal criterion is the patrimoniality of the matter, what is a patrimonial matter is controversial and different interpretations arise including an identification with the former criterion. For a discussion under current law see: A. Menezes Cordeiro, *Tratado da Arbitragem. Comentário à Lei 63/2011, de 14 de Dezembro*, Almedina-Coimbra 2015, 94.

[3] Article 2 (1) of the Spanish Arbitration Act (B.O.E. 2003, 60); Article 2059 of the French Civil Code [C. CIV.]; Articles 808 and 1966(2) of the Italian Civil Procedure Code [C.p.c.]; Article 1 of the Peru Arbitration Act (2008); Organization for the Harmonization of Business Law in Africa (OHADA), Uniform Act of Arbitration (1999); Art. 1 of the Arbitration Law of Angola.

[4] Article 177(1) of the Swiss Private International Law, Dec. 18, 1987, RO 1776; German Code of Civil Procedure Jan. 30, 1877, Article 1030(1) of the German Reichsgesetzblatt.

[5] In Brazil, Law 9.307/1996 on Arbitration (Lei No. 9.307, de 23 de Setembro de 1996, *Diário Oficial da União* [D.O.U.] (t. 1): de 24.9.1996 (Braz.)) refers to *Direitos patrimoniais disponíveis* as a criterion for determining arbitrability, combining two of the most popular criteria found in domestic laws.

About the meaning of *Direitos patrimoniais disponíveis,* scholars in Brazil: H. Malheiros Duclerc Verçosa, "Doze anos da lei de arbitragem: alguns aspectos ainda relevantes", *Aspectos da arbitragem institucional. 12 anos da Lei 9.307/1996*, Malheiros editores 2008, 16, refers to patrimonial disputes available as all those involving quantifiable interests in money, in respect of which the parties are free to compromise; and C. M. C. Penteado, Jr., "Os Direitos patrimoniais disponíveis e as regras de julgamento na arbitragem", *Revista de Arbitragem e Mediação* 20/2009, 80–85, considers, everything that may be an object of transaction, which equates to the availability of the right or the possibility of resignation to an existing right.

[6] Zivilprozessordnung [ZPO] [Civil Procedure Statute] Reichgesetzblatt [RGBl] No. 113/1895 (Austria); Article 2 of the Finnish Arbitration Law (Oct. 23 1992); Article 13 (1) of the Japanese Arbitration Law, Law No. 138 of 2003; Article 1 (a) of the § Lag om skiljeförfarande (Svensk författningssamling [SFS] 1999:116) (Swed.).

nomic sectors by establishing limits to arbitrability. Domestic cases on arbitrability are seen from time to time in different jurisdictions. Even if we consider typical commercial areas – intra-corporate disputes, securities, intellectual property, fair and unfair competition, distribution contracts, financial contracts, insurance, transport, insolvency, or regulated economic sectors (including energy) – the different approaches to arbitrable subject matters taken by domestic laws, scholars and case law has created uncertainty. There are different reasons for adopting limitations such as public policy, the need to protect the essential conditions of a given market, or the idea that there is a weaker party and thus the need to protect it because of the unequal bargaining power of the parties and the imposition of arbitration by one of them. This is the case seen in certain countries: to protect consumers, commercial agents, distributors,[7] or franchisees, for example.

Contrarily, no discussion about arbitrability is needed if the very same State, in order to enhance arbitration or to facilitate the access to justice, declares certain matters to be mandatorily subject to arbitration and therefore it is clear that there is no discussion about arbitrability.[8]The difference in perspectives adopted at domestic levels on arbitrability is due to a certain extent to the lack of a uniform international rule on arbitrability. Neither the 1985 UNCITRAL Model Law on International Commercial Arbitration (MAL)[9] nor its 2006 revision[10] contain a provision dealing with arbitrability. The legislative history is clear on this point:

> *"The prevailing view was that the Model Law should not contain a provision delimiting non-arbitrable issues."*[11]

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[7] Distribution contracts are commercial contracts. Traditionally, commercial contracts may be subject to arbitration without the need to impose limitations. The rationale behind this general rule is that in commercial contracts, both parties share equal contracting power and thus there is no need to impose limitations. Among others: J. Kleinheisterkamp, "The Impact of Internationally Mandatory Law on the Enforceability of Arbitration Agreements", *LSE Law Society and Economic Working Papers* 22/2009, 1–2, *http://ssrn.com/abstract=1496923*, last visited 6 November 2017 (see for with special reference to distribution contracts); S. Kröll, "The 'Arbitrability' of disputes arising from Commercial Representation", *Arbitrability. International & Comparative Perspectives*, Wolter Kluwers, 2009, paras. 16–3; P. Perales Viscasillas, "The Good, the Bad, and the Ugly in Distribution Contracts: Limitation of Party Autonomy in Arbitration?", *Penn. St. J.L. & Int'l Aff* 4/2015, 213–241.

[8] C. Trabuco, M. Francça Gouveia, 456.

[9] *http://www.uncitral.org/pdf/english/texts/arbitration/ml-arb/06–54671_Ebook.pdf*, last visited 6 November 2017.

[10] *http://www.uncitral.org/pdf/english/texts/arbitration/ml-arb/07–86998_Ebook.pdf*, last visited 6 November 2017.

[11] A/CN.9/216, 23 March 1982, No. 30. *http://daccess-dds-ny.un.org/doc/UNDOC/GEN/V82/252/94/PDF/V8225294.pdf?OpenElement*, last visited 6 November 2017.

Despite that conclusion, arbitrability was repeatedly included in the agenda for the MAL revision.[12] The UNCITRAL Working Group II considered the differences in domestic laws and the uncertainties derived from distinct legal solutions towards arbitrability to be problematic for international arbitration.[13] Although the general trend in domestic laws is a broader approach to submitting to arbitration matters that have been traditionally outside of its scope, incorporation of an arbitrability rule within the MAL could be deemed both necessary and possible. First, consideration should be given to the lack of uniform solutions in the law. Due to the MAL's silence on the issue, it is clear that there is no uniform approach to arbitrability. Second, arbitrability is an important issue to be analyzed both by the arbitrators during the arbitration procedure (*ex officio*) and by the courts at the beginning, if an exception of competence is presented,[14] or after the arbitration (also *ex officio* as arbitrability is a

[12] A/CN.9/216, 23 March 1982, No. 30−31. *http://daccess-dds-ny.un.org/doc/UNDOC/GEN/V82/252/94/PDF/V8225294.pdf?OpenElement*, last visited 6 November 2017. It was also considered by the Commission it its 36th session (Vienna, 30 June − 11 July 2003), *http://daccess-dds-ny.un.org/doc/UNDOC/GEN/V82/252/94/PDF/V8225294.pdf?OpenElement*, last visited 6 November 2017, 37th (New York, 14−25 June 2004) *http://daccess-dds-ny.un.org/doc/UNDOC/GEN/V04/562/43/PDF/V0456243.pdf?OpenElement*, last visited 6 November 2017, and 38th (Vienna, 4−15 July 2005), *http://daccess-dds-ny.un.org/doc/UNDOC/GEN/V05/868/63/PDF/V0586863.pdf?OpenElementsessions*, last visited 6 November 2017). In particular, the Commission noted that priority consideration might be given to the issue of arbitrability of intra-corporate disputes, as well as arbitrability in the fields of immovable property, insolvency and unfair competition, see: A/CN.9/610, 5 April 2006, No. 6, at *http://daccess-dds-ny.un.org/doc/UNDOC/GEN/V06/526/16/PDF/V0652616.pdf?OpenElement*, last visited 6 November 2017; and A/61/17, No. 183, *http://daccess-dds-ny.un.org/doc/UNDOC/GEN/V06/558/15/PDF/V0655815.pdf?OpenElement*, last visited 6 November 2017.

[13] A/CN.9/610, 5 April 2006, No. 8, *http://daccess-dds-ny.un.org/doc/UNDOC/GEN/V06/526/16/PDF/V0652616.pdf?OpenElement*, last visited 6 November 2017 .

[14] In regard to this case, recently the High Supreme Court of Spain, 27 June 2017 (No. 3292/2014) analysed the two different criteria. The first would be the so-called *strong thesis* of the kompetenz-kompetenz principle, which is the one held by the appellant, according to which the judicial body's action in case of a declinatory approach should be limited to superficial analysis, the existence of the arbitration agreement, and, if there is such an agreement to consider the declination, for the arbitrators to decide on their own jurisdiction. Only by way of subsequent action to annul the award (which could be a partial award, in which the arbitrator or arbitrators were limited to decide on their own jurisdiction), the judicial bodies could review the decision of the arbitrators on their jurisdiction. The second would be the so-called weak thesis, according to which the judicial body before which the declination of jurisdiction for submission to arbitration is considered must carry out a complete examination of the validity, effectiveness and applicability of the arbitration agreement. Thus, if the judge considers that the arbitration agreement is invalid, is not effective or is not applicable to the issues subject to the claim, the court will reject the declination and will continue to hear the litigation. This court considers that there is no reason to uphold the strong thesis of the kompetenz-kompetenz principle in our legal system and to limit the scope of the judge's knowledge when he resolves the declination of jurisdiction by submission to arbitration.

ground for setting aside an award (Art. 34 MAL) and for denying its enforcement (Art. 36 MAL and New York Convention Art. V.2(a)). Additionally, the fact that general and broad definitions are present in many arbitration laws does not help to build a uniform solution, since arbitrability in specific areas is subject to scholarly interpretation and judicial decisions that may be based on national conceptions, limiting arbitrability of the subject matter of the dispute. Furthermore, legal certainty is rarely achieved due to the fact that many states address arbitrability in specific laws.In terms of finding a uniform solution for an arbitrability rule, the Working Group II foresaw a possible design of the rule on arbitrability: a general formula and a uniform list of exceptions.[15] This kind of solution would be easy to implement and would contribute greatly to uniformity in this area. The UNCITRAL could take a leading role in creating a uniform and international solution, calling attention to the need to strengthen the boundaries of arbitrability to states that are reluctant to do so. However, in terms of uniformity, the mentioned solution would not suffice. Further consideration should be given to the design of more complex rules for specific subject matters that are highly controversial under domestic laws. To provide one example, intra-corporate disputes are quite a complex area, where one encounters traditional misconceptions, arguments and limitations against arbitration: imperative rules, public order, the impact of third party rights, and the exclusive competence of state courts. The problems, however, are not limited to arbitrability; procedural aspects also need to be studied, including the impact of arbitration of intra-corporate disputes on third parties, the effect of the award on commercial registries, confidentiality versus transparency, and the permissibility of arbitration in equity.As this brief survey of problems shows, a general formula on arbitrability would not be sufficient to tackle all of the issues that arise from the possibility of submitting intra-corporate disputes to arbitration. Specially tailored provisions would be needed to provide uniformity and certainty in this area. A work by the UNCITRAL in the area of arbitrability of commercial disputes would help to fill an important gap in the MAL and to achieve desired uniformity, international

[15] A/CN.9/610, 5 April 2006, No. 8, *http://daccess-dds-ny.un.org/doc/UNDOC/GEN/V06/526/16/PDF/V0652616.pdf?OpenElement*, last visited 6 November 2017: "Work might be geared, for example, towards formulating a uniform provision setting out three or four issues that were generally considered non-arbitrable and calling upon States to list any other issues that are regarded as non-arbitrable by the State. At the same time, concerns were expressed that any national listing of non-arbitrable issues might be inflexible and therefore counter-productive. It was said that the question of arbitrability was subject to constant development (including through case law) and that some States might find it undesirable to interfere with that development (see below, para. 13)." This simple solution was already in place in 1982: "it was noted that further thought could be given to the possibility of devising a general formula to determine non-arbitrability along the following lines –a subject matter is arbitrable if the issue in dispute can be settled by agreement of the parties" (A/CN.9/216, 23 March 1982, No. 30−31).

consensus, and legal certainty in the arbitration world. Until that moment, we still have to struggle with the different views of arbitrability in domestic legal systems. The object of this paper is to explore whether the general principle pro arbitration and arbitrability in Spain is threatened by doctrinal interpretations and recent judicial decisions where arbitrability has been constrained.

2. AN OVERVIEW OF ARBITRATION IN SPAIN: DOMESTIC AND INTERNATIONAL

The law in force in Spain is Law 60/2003 on Arbitration, of 23 December, 2003, which follows to a great extent, although with some departures, the 1985 UNCITRAL Model Law on International Commercial Arbitration (MAL). The Procedural Law of 2000 also contains several provisions on arbitration. The Spanish Arbitration Law is a general law for arbitration and thus private legal issues, including both commercial and civil transactions, are included, with the exception of labour law disputes, which are excluded from the scope of the aforementioned Law. One of the main objectives of the new law was to promote Spain as a seat for international arbitration. The purposes of both the 2003 Arbitration Law and the modifications operated on it by Law 11/2011[16] are in line with the objective to promote and develop arbitration in Spain and to attract international arbitration:

a) to contribute to improve the ADR methods and to definitely launch arbitration in Spain;
b) to improve the conditions for establishing international arbitration in Spain and to increase legal security of arbitration, in order to enhance arbitral proceedings particularly from an international perspective;
c) to strength institutional arbitration;
d) to clarify doubts in relation to certain matters, such as corporate arbitration and arbitration within insolvency proceedings; and
e) to increase legal security and efficiency of arbitral proceedings. As opposed to the old Law from 1988, which considered a dual system depending on the domestic or international character of the arbitration, the 2003 Law on Arbitration unifies the rules of both types of arbitrations. Therefore, while the preference is the

[16] By Law 11/2011, 20 May 2011, the 2003 Arbitration Act is modified with effect from June 10, 2011. See Law 11/2011, 20 May 2011, that reforms Law 60/2003, 23 December, 2003, on Arbitration and institutional arbitration in the General Administration of the State (BOE, núm.121, 21 May 2011).

so-called monist system, there are still a few, but clearly justifiable, special rules that have been adopted for international arbitration. Furthermore, the Law sets forth a general system applicable to any kind of arbitration lacking special arbitration rules, and even in such cases recourse may be made to the supplementary law (Art. 1.3 LA). Labour arbitration is excluded. The Law defines "international" arbitration very broadly and flexibly, in accordance with the Model Law. According to the Spanish Arbitration Law, an arbitration is "international" if any of the following circumstances have been met: if, at the time the arbitration agreement is made, the parties have their legal residences in different countries; if the place of arbitration, as determined in the arbitration agreement, the place of the performance of a substantial part of the legal obligations from which the dispute arises, or the place where the dispute has its closest ties is situated outside of the country where the parties have their legal residences; or if the legal relationship from which the dispute arises affects the interests of international trade. The last criterion is a new one, when compared to those from the Model Law, but it is a criterion that is widely developed in other legal systems. Following the Model Law, the Law also avoids the confusion that multiple domiciles of a party could cause in determining whether the arbitration is international or not. The national or international character of the arbitration, however, is distinct from the domestic or international character of the award.

The Arbitration Law applies to all arbitral proceedings, whether domestic or international, where the place of arbitration is within Spanish territory, but there can be extraterritorial application of some of the rules: judicial granting of interim measures; an order enforcing the award; *exequatur* of foreign arbitral awards; the form and contents of the arbitration agreement, except when the arbitration agreement appears in a standard-form contract; objections to jurisdiction; and interim measures granted by the arbitrators. The international character of the arbitration, as mentioned, determines the application of special rules, the more relevant among these being: the validity of the arbitration agreement (Art. 9.6), and the substantive rules applicable to the contract (Art. 34.2). Spain is also a party to the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, the Geneva Convention on the Execution of Foreign Arbitral Awards of 1927, and the Washington Convention on the Settlement of Investment between States and Nationals of Other States of 1965. Spain has also signed bilateral on the recognition and enforcement of foreign decisions, including arbitral awards, and more

than 50 BITs that include arbitration clauses. Special arbitration rules and even arbitral systems are included in different laws in Spain. The most important being:

a) *consumer arbitration*: a special system for consumer arbitration is presently contained in Royal Decree 231/2008, of 15 February, on Arbitral Consumer System (Sistema Arbitral de Consumo), which supersedes regulation 636/1993, of 3 May;[17]

b) *corporate disputes*: new articles 11 bis[18] and ter have been included in the modification of the 2003 Arbitration Law by Law 11/2011, of 20 May, considering the possible inclusion of arbitration clauses in the corporate bylaws, and thus confirming what was the old approach in Spain.[19] For example, the Regulation of the Commercial Registry was modified on 16 March 2007 to introduce a provision where the bylaws of all types of corporations might include a provision on arbitration (Art. 114.2 and Art. 175.2).[20] These rules state that the bylaws can include an arbitration clause for intra-corporate disputes among the shareholders, or between the shareholders and the corporation or its bodies. Also, the Law on Professional Entities (*Ley de Sociedades Profesionales*) of 16 March 2007 allows for the arbitration of, *inter alia*, disputes related to the withdrawal, squeezing-out, or determining of the equity interest in a professional entity.Spain has a long tradition in corporate arbitration and thus to facilitate the submission of intra-corporate disputes to arbitration, the interested bodies have drafted model arbitration clauses as well as special

[17] See: M. Richard González, I. Riaño Brun, J. M. Rifá Soler, *Estudios sobre arbitraje de consumo*, Thomson Reuters, 2011; P. Perales Viscasillas, "Los convenios arbitrales con los consumidores (La modificación del art. 57.4 TRLGDCU por la Ley 3/2014 de 27 de marzo)", *La Ley Mercantil* 7/2014, 1–22.

[18] Article 11 bis of the Law of Arbitration: "1. Companies may submit disputes arising within them to arbitration.

2. Insertion into a company's articles of association of a clause providing for submission of disputes to arbitration shall require favourable vote representing at least two thirds of the share capital of the company.

3. A company's articles of association may provide that any challenge to corporate resolutions by members or directors shall be subject to the decision of one or more arbitrators, designating an arbitration institution to administer the arbitration proceedings and appoint the arbitrator(s)."

In Peru (MAL country), through the Arbitration Act, the General Law on Corporation is modified as to include a provision dealing with intra-corporate disputes (see Art. 48 of Law No. 26887).

[19] P. Perales Viscasillas, *Arbitrabilidad y Convenio arbitral (Ley 60/2003 de Arbitraje y Derecho Societario)*, Thomson-Aranzadi, Navarra, 2005.

[20] In regard to condominium division, where arbitration is very popular, arbitration clauses contained in the bylaws are considered valid. See Madrid Appellate Court, 26 September 2006.

procedural rules to be incorporated into corporate bylaws or articles of incorporation, as well as model clauses and procedural rules for arbitral institutions.[21] – *intellectual property rights*: Royal Decree 1/1996 on the Intellectual Property Rights Law, of 12 April, set up an Intellectual Property Rights Commission that can arbitrate disputes between the participants in this sector;

c) *trademarks and industrial designs*: Law 17/2001 on Trademarks, of 7 December, and Law 20/2003 on Industrial Designs,[22] of 7 July, establish the right to arbitrate disputes that may arise during the process of registering a trademark or a design.[23] As noted, while not a purely private legal issue, it is an issue that is part of an administrative procedure, albeit between private parties. Therefore, in such cases arbitration supersedes administrative recourse and is the final, binding award on the parties.[24] The existence of specific legal provisions in the area of validity of industrial property rights is rare but there are some exceptions.[25] Of course, regular private arbitration between parties, having to do with the usual contractual issues related to trademarks or industrial design, is also available;[26]

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[21] See Report on Corporate Arbitration and Model Arbitration clause offered by the Spanish Club of Arbitration, *http://www.clubarbitraje.com/files/docs/cea_Arbitraje_Societario.pdf*, last visited 6 November 2017 and the new rules for corporate arbitration included in the Rules of Arbitration of the Court of Arbitration of Madrid (in force from 1 March 2015, Art. 52).

In fact, such model clauses and special procedural rules are increasingly common. Examples include the Mauritius International Arbitration Act (model clause), *http://www.wipo.int/edocs/lexdocs/laws/en/mu/mu020en.pdf*, last visited 6 November 2017, and the model arbitration clause and supplementary rules offered by the DIS (German Institution for Arbitration), *http://www.disarb.org/en/16/regeln/dis-supplementary-rules-for-corporate-law-disputes-09-srcold-id15*, last visited 6 November 2017.

[22] BOE, No. 294, December 8, 2001; and BOE, No. 162, July 8, 2003.

[23] Article 28: 1. The persons concerned may submit to arbitration the matters in dispute arising in connection with the procedure for the registration of a trademark in accordance with the provisions of this Article.

2. The arbitration may only deal with the relative prohibitions provided for in Articles 6.1.b), 7.1.b), 8 and 9 of this Law. In no case may questions be submitted to arbitration regarding the occurrence or not of formal defects or absolute prohibitions of registration.

[24] P. Perales Viscasillas, "Arbitrabilidad de los derechos de la propiedad industrial y de la Competencia", *Anuario de Justicia Alternativa, Derecho Arbitral* 6/2005, 11–76.

[25] See: A. De Miguel Asensio, "Alcance de la arbitrabilidad de los litigios sobre derechos de propiedad industrial", *Arbitraje* 1/2014, 88–90, considering also the expansion of arbitrability in this area.

[26] Article 40: The owner of a registered trademark may bring before civil courts or criminal proceedings against those who injure his right and demand the necessary measures to safeguard it, without prejudice to submission to arbitration, if possible.

d) *patents*: Different to the old patent law, which was silent on the possible submission of disputes to arbitration and thus scholars held different views on this, the Law 24/2015 on Patents, 24 July, (BOE, nº177, 25 July 2015) considers the possible arbitration in this area although with some restrictions to arbitrability;

e) *transport law*: Law 16/1987, of 30 July, contemplates a special system under the Transport Arbitration Board and its regulation;

f) *probate proceedings*: The arbitration law includes a special rule that weighs the validity of arbitration, instituted by testamentary disposition, which resolves differences among heirs-apparent or beneficiaries over issues concerning the distribution or administration of an estate (Art. 10);

g) *administrative contracts*: Royal Legislative Decree 3/2011, 14 November, on Contracts made by the Public Administration as well as its predecessor (Law 30/2007, of 13 October) stipulates that these contracts may be subject to arbitration when the entities of the public sector do not have the character of a public administration institution. Therefore, private administrative contracts – but not public administrative contracts – may be subject to arbitration under the 2003 Law on Arbitration (Art. 50, and Additional Disposition 1, nº3 in relation to international contracts) without the need of previous approval to submit disputes to arbitration;[27]

h) *regulated sectors*: There are several trade sectors, formerly subject to the monopoly of the State, that are now partly or completely in the

[27] Also at a comparative level, there are countries which also have evolved towards an opening for arbitration in public contracts. See, for Brazil, where three main positions are considered as to the conceptual understanding of arbitrability. The first is to revert the old prohibitive rule in such a way that the existence of a presumption of the arbitrability of contractually regulated state rights and interests can be maintained; the second is to consider that arbitration is prohibited only when judicial intervention is necessary; and third is that a general rule on arbitrability has the exception for issues that involve essential public interests. Hence the opening of arbitration in the area of administrative law, also fostered by the new guidelines in the negotiation-contractual activity of the Administration: E. Talamini, "A (in) disponibilidade do interesse público: conseqüências processuais (composições em juízo, prerrogativas processuais, arbitragem e ação monitória", *Revista de Processo* 128/2005, 69–71; G. H. Justino de Oliveira, "A Arbitragem e as Parcerias Público-Privadas", *Revista de Direito Administrativo*, 2005, 248; D. Zimmermann, "Alguns aspectos sobre a arbitragem nos contratos administrativos à luz dos principios da eficiencia e do acceso à justiça, por uma nova concepção do que seja interesse público" *Revista de Arbitragem e mediaçao*, 2/2007, 69–92; L. Da Gama e Souza, Jr., "Sinal verde para a arbitragem nas parcerias público-privadas (A Construção de um novo paradigma para os contratos entre o Estado e o Investidor privado)", *Revista de Direito Administrativo* 2/2005, 134–140; and G. Ettore Nanni, *Direito Civil e Arbitragem*, Atlas, Sao Paulo, 2014, 99–100.

hands of the private sector – for example: energy, telecommunications, and postal services. Initially, under the special rules of these sectors, and also in the general law on free competition,[28] a special arbitration system was considered, and thus an open view in regard to arbitrability was considered.[29] However, the system was in the hands of special regulatory bodies, without the prejudice of private arbitration.

Since 2013, all the arbitration systems in the regulated sectors have been integrated into a single one, under the newly created National Commission on the Markets and Competition. It is interesting to mention that the arbitration system adopts the UNCITRAL Arbitration Rules (UAR) as institutional rules in regard to disputes under the new body: the National Commission on the Markets and Competition.[30] The arbitration procedure would be subject to UAR or, as the case may be, to rules laid down by the National Commission.[31] In this paper we will further consider certain issues related to arbitration and arbitrability in the area of the regulated sectors.

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[28] Formerly contained under Law 15/2007 on Competition, of 3 July, and its regulation of 27 February 2008, which establishes a special procedure for arbitration.

[29] The opening to arbitration is noticeable in regulated sectors, such as energy, oil and gas mainly, in other countries, i.e. Brazil, where in relation to concession contracts these resources are considered in the scope of free availability of the parties, since this is not a public service, according to the Brazilian constitution, allowing the Petroleum Law to submit disputes to arbitration, and also in the area of public-private partnerships (PPS) which expressly allows, in the contract model, the resolution of disputes between the concessionaire and the State, arbitration whose place of arbitration should Brazil and conducted in Portuguese language. See: J. A. Bucheb, *A arbitragem internacional nos contratos da industria do petróleo*, Lumen Juris 2002, 12–14; L. Da Gama e Souza, Jr., 121–157.

[30] See P. Perales Viscasillas, "The role of arbitral institutions under the 2010 UNCITRAL Arbitration Rules", *Lima Arbitration*, 6/2014, 26–76, *http://www.limaarbitration.net/LAR6/Pilar_Perales.pdf*, last visited 6 November 2017.

[31] See: Royal Decree 657/2013, 30 August, on the Organic Rules to the National Commission on the Markets and Competition (BOE, No. 209, 31 August 2013):

Arbitration function

1. The National Market and Competition Commission may perform the functions of institutional arbitration, both in law and in equity, entrusted by the laws and those submitted voluntarily by economic operators, pursuant to Law 60/2003 on Arbitration, of 23 December.

2. The arbitration procedure shall conform to the principles of hearing, evidence, contradiction and equality and shall be subject to the rules of the United Nations Commission for Commercial Law or, as the case may be, those determined by the Council of the National Commission of Markets and Competition. An abbreviated procedure may also be envisaged depending on the level of complexity of the claim and its amount. 3. The Board of the National Market and Competition Commission is responsible for the administration of arbitration, each of the chambers being able to appoint arbitrators and determine the fees according to the tariffs approved by the Council.

3. GENERAL NOTIONS AND PRINCIPLES IN REGARD TO ARBITRABILITY IN SPAIN

3.1. The notion and functions of arbitrability

The distinction between objective arbitrability (arbitrability *rationae materiae*, *i.e.* matters that can be settled by arbitration) and subjective arbitrability (authority and capacity) is adopted in the Spanish Arbitration Law (Art. 2), in line with the general trend among scholars[32] and other arbitration laws.

Article 2.1 refers to objective arbitrability, considering the fact that all disputes relating to matters that may be freely disposed of by law can be settled by arbitration. The Spanish Law follows the general consideration under domestic laws of defining arbitrability under general standards. These general clauses require specification and interpretation in order to assess which of the specific issues related to a general matter are arbitrable. Although a case by case analysis is needed, generally speaking, in the field of commercial matters, most issues are arbitrable, as is also the case with civil matters, with the exception of certain family affairs. Furthermore, in very few cases, it is the law that confines the issues that are not subject to arbitration and thus establishes a clear line on the given matter. A clear example of that is Article 136 of the Patent Law (2015), which allows arbitration in regard to disputes on patents subject to the general rule on arbitrability (Art. 2.1 Arbitration Law). Furthermore this provision specifies the specific issues that are not arbitrable: "The matters relating to the concession, opposition or remedy procedures related to the titles regulated in this Law are not freely disposed, and the mediation or arbitration, when the object of the controversy is the fulfilment of the requirements for its grant, maintenance or validity".[33] In addition, the Spanish body entrusted with the entire registered system (OEPM, *Oficina Española de Patentes y Marcas*) is allowed to function as an arbitral institution.[34] Back to the general rule on arbitrability, it is

[32] K. Sajko, "Arbitration Agreement and Arbitrability. Solutions and Open Issues in Croatian and Comparative Law", *Croatian Arbitration Yearbook*, 3/1996, 43 (some authors also refer to arbitrability *ratione jurisdictionis*); A. Uzelac, "New Boundaries of Arbitrability under the Croatian Law on Arbitration", *Croatian Arbitration Yearbook* 9/2002, 139 (referring also to arbitrability *ratione institutionis*).

[33] For the scholars positions on the new Law on Patents, see: A. De Miguel Asensio, 81–101, with further references, considering that under Spanish law the better and prevailing view is that arbitrators may decide on issues of validity of industrial property rights, where validity arises in a context other than by principal claim and provided that the decision on validity only has an *inter partes* effect. Partial different view: P. Perales Viscasillas (2005b), 40.

[34] See Article 3 of the Royal Decree No. 1270/1997, 24 July, as modified by the Patent Law.

usually considered very broadly and in general terms that those rights that cannot be waived (Art. 6.3 Civil Code of Spain), as well as those related to the rights inherent to human beings, those which are at the same time a duty or linked to an obligation (state and capacity of persons, family law, etc.). Furthermore, also non-arbitrable are those that affect third parties etc., while, as a rule, the patrimonial relations are arbitrable.[35]
Subjective arbitrability has a special rule in regard to international arbitration and when one of the parties is a state or company, organization, or enterprise controlled by a state, where that party may not avail itself of the privileges of its domestic law to avoid its obligations under the arbitration agreement.[36] The intention, as recognised in the Preamble of the Arbitration Law, is that a state shall be treated exactly the same as a private party. To this regard, Royal Legislative Decree 3/2011 on Administrative Contracts, of 14 November, provides that when the contracts are concluded and executed outside Spain, the inclusion of an arbitration clause is recommended. As international and domestic practice reveals, it is not uncommon for some states to invoke the non-arbitrability of the question submitted to arbitration in order to escape the arbitration agreement, in the understanding that the matter is not subject to arbitration under national law on grounds of public policy.[37]

In Spain, where the entire system of arbitration is based upon a voluntarily arbitration, as opposed to a mandatory arbitration, a notion of arbitrability is needed in order to draw a line between the matters that might be subjected to arbitration. Also, from the Spanish perspective it is up to the State to decide what matters are arbitrable, and thus to exclude or include matters from the scope of the subject matter of arbitrability. Therefore, it is not for the parties to decide the definition or scope of arbitrability in the arbitration agreement, and thus they cannot transform a matter that is not arbitrable into an arbitrable one, merely by their desire. Thus, an arbitration agreement over an non-arbitrable matter is invalid and the arbitrators cannot render a valid arbitration award. What the parties are able to do is to limit the scope of the issues that may be the object of arbitration, and thus an arbitrable matter may be excluded by the wish of the parties as expressed in the arbitration agreement.

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[35] STSJC 4/02/2016 (M. Eugenia Alegret) (No. 3/2014).

[36] Article 2 (2) of the Spanish Arbitration Act: *2.* In international arbitration, when one of the parties is a State or a State-controlled company, organisation or enterprise, that party may not invoke prerogatives of its own law to circumvent obligations stemming from the arbitration agreement.

For a description of the immunity of States under Spanish Law see: Juzgado de Primera Instancia de Madrid, 5 September 2016 (No. 394/2016).

[37] See: R. S. Grion, "Breves notas sobre a participação do Estado em Arbitragem Comercial. Arbitragem e comercio internacional", *Estudos em homenagem a Luiz Olavo Baptista*, Quartier Latin do Brasil, 2013, 863.

3.2. A general policy principle that favours arbitrability under Spanish Law

Some scholars have considered that under Spanish Law the specific application of the principle of *favour arbitris* to arbitrability means that there is a general presumption in favour of the arbitrability of commercial disputes (*policy favouring arbitrability*);[38] and also that there is a clear tendency to expand the scope of the subject-matter of arbitration as considered in the previous section (*supra* II). The principle of favouring arbitrability is seen under Art. 9.6 Law 60/2003, applicable to international arbitration, which considers that the matter is subject to arbitration if admitted under any of the following laws: rules of law chosen by the parties to deal with the arbitration agreement or the contract, or by Spanish Law.[39] One example is the insolvency law. Initially, the insolvency law of 2003 considered that without the prejudice of international treaties, the arbitration agreements to which the debtor was a party would have neither value nor effect during the insolvency procedure (Art. 52).[40] Further, Law 11/2011 tried to adapt Art. 52 of the Insolvency Law to the European Union solutions (Regulation 1346/2000) and to eliminate the incoherence between paragraphs 1 and 2 of Art. 52, which were object of severe criticism by scholars. The singularity of the Spanish insolvency law, in regard to arbitration, was highly criticised by scholars, and so the new regulation has to be assessed. According to the new regulation,[41] the declaration of the in-

[38] B. Hanotiau, "L`Arbitrabilité et le favor arbitrandum: un réexamen", *Journal du Droit International* 1994, 899; G. Born, *International Arbitration: Law and Practice*, Wolters Kluwer Law & Business, 2012, 82.

[39] Article 9 (6) of the Spanish Arbitration Act (2003) whereby: "When the arbitration is international, the arbitration agreement shall be valid and the dispute may be subject to arbitration if the requirements stipulated by the law chosen by the parties to govern the arbitration agreement, the law applicable to the substance of the dispute, or Spanish law, are fulfilled."

[40] Article 52 of the Arbitral Procedures. "1. The arbitration agreements in which the debtor is a party shall have no value or effect during the procedure of insolvency, without prejudice to the provisions of international treaties.

2. The arbitration proceedings in process at the time of the declaration of insolvency will continue until the finality of the award, being applicable the rules contained in paragraphs 2 and 3 of the previous article."

For the rule that was applied strictly: see Auto Appellate Court of Barcelona, 29 April 2009, with a critic commentary by I. H. Cervantes, *Revista de Arbitraje Comercial y de Inversiones* 3/2010, 841–849.

[41] Article 52 of the Arbitration Proceedings.

"1. The declaration of insolvency proceedings alone does not affect mediation clauses or arbitration agreements signed by the insolvent debtor. When the jurisdictional body understands that such clauses or agreements may cause harm to the process of the insolvency proceedings, it may rule to suspend their effects, without prejudice to the provisions set forth in the international treaties.

solvency proceedings, in itself, does not affect the arbitration or conciliation agreements concluded by the insolvent. However, without the prejudice of international agreements, the insolvency court might suspend the effect of the agreements if it considers them to be an obstacle for the insolvency proceedings. It is worth mentioning that the new provision also refers to the conciliation agreements and not only to arbitration agreements, which was the previous rule. The system is completed with a special rule for consumer arbitration.[42] Despite this general policy favouring arbitrability, recent court decisions in Spain have considered that a maximalist standard of review applies when setting aside an award due to the non-arbitrability of the subject matter of the dispute, i.e. the court can fully review the facts and the law as considered by the Arbitral Tribunal.[43]

4. OBJECTIVE ARBITRABILITY: SOME RESTRICTIONS AT LAW

As considered earlier, the general provisions on arbitrability under Art. 2 of the Spanish Arbitration Act need to be interpreted in order to assess whether specific disputes are arbitrable. Despite this modern approach to arbitrability already seen, some recent limitations to party autonomy, either minor, such as it will be seen in the case of corporate arbitration, or of a broader range, by restricting objective arbitrability of the dispute,

2. Arbitration proceedings in progress at the moment of declaring the insolvency proceedings open shall continue until the award is final, the rules set forth in Paragraphs 2 and 3 above being applicable.

Article 53 of the Final Court Rulings and Arbitration Awards:

1. The final rulings and awards handed down before or after the declaring open insolvency proceedings shall be binding to the Court of the latter, which shall hand down the decisions for the appropriate insolvency treatment.

2. What is set forth in this Article is understood to be notwithstanding the right of the insolvency practitioners to contest arbitration bonds and proceedings in the event of fraud."

For further references see: M. F. Martín Moral, *El concurso de acreedores y el arbitraje*, La Ley/Wolters Kluwer 2014; P. Perales Viscasillas, "Artículos 52 y 53 de la Ley Concursal", *Comentario a la Ley Concursal*, La Ley/Walters Kluwer, Madrid 2016, 698–711.

[42] See Article 58 (2) of the General Law on Consumers: "Arbitration agreements and public offerings of adhesion to consumer arbitration, where made by those who have been declared subject to bankruptcy proceedings, shall be invalid. For such purposes, the notice of commencement of bankruptcy proceedings shall be communicated to the body through which the agreement was drawn up, and to the National Consumer Arbitration Board, with the debtor subject to bankruptcy proceedings excluded from the Consumer Arbitration System, for all purposes, from this time."

[43] Among others, STSJ de Madrid, 3 November 2015 (No. 7/2015).

excluding arbitration before the dispute has arisen, excluding it through the imposition of the exclusive jurisdiction of the State Courts, or judicial decisions (*infra* V), threaten this optimistic view about arbitrability in Spain.

4.1. Corporate Arbitration

Very few statutes address arbitrability in regard to corporations. Some link arbitrability with the general standards provided in arbitration laws, however, others consider a wider scope of issues, sometimes limiting the scope of arbitrability to certain intra-corporate disputes or limiting the persons subject to arbitration. Although since the 2011 reform of the Spanish Arbitration Act, Spain expressly allows arbitration for corporations (closed corporations and publicly-held corporations),[44] confirming an approach favourable to arbitration,[45] *ad hoc* arbitration in case of challenges to corporate resolutions is, in principle, prohibited. Furthermore it is required that all arbitrators be appointed by the institution. Moreover, the Spanish Arbitration Act (Art. 11 bis and ter) requires a supermajority vote of shareholders for the introduction of an arbitration clause into corporate bylaws and does not recognise the appraisal rights of dissenters, in contrast to other national legislations, such as in Italy,[46] where dissenters have appraisal rights, and under the Mauritius International Arbitration Act, where a unanimous vote of current shareholders is required (Section 3(6)). Under Spanish Law, arbitration is allowed both in equity and in law,[47] as opposed to Italian Law, which forbids arbitration in equity.[48]

[44] In contrast, Italian law forbids it (Legislative Decree of 17 January 2003, No. 5).

For Italian scholars see: L. Boggio, *Deliberazioni assemblearie "diritti disponibili relative al rapport sociale"*, EDUCatt, 2012.

[45] STSJ Castilla-La Mancha, 24 November 2016 (No. 13/2016) and STSJM, 9 February 2016 (No. 15/2016).

[46] Legislative Decree of 17 January 2003, No. 5 as amended further, Title V – On Arbitration.

For a comparative analysis of Italy and Spain, see the different papers at: L´arbitrato societario in Spagna e in Italia. Un`analisi comparata, *Giurisprudenza Italiana* 6/2014, 1522−1544.

[47] Same position in Chile, where a complex arbitration rules are interpreted in a very different way by scholars. See: E. Jequier Lehuedé, "El arbitraje en el Derecho Chileno de Sociedades", *Arbitrabilidad del conflicto societario mercantile*, Thomson/Reuters, 2013, 322−323.

[48] Other limitations seen at a comparative level include, for example, the Arbitration Law of Mauritius, which requires the juridical seat of any arbitration under the Act to be Mauritius. Italian law requires all arbitrators to be appointed by a third person unrelated to the company, and requires the request for arbitration to be publicly registered and available for inspection. Italian law also allows third-party intervention, in which the award is binding on the company, even if the company was not party to the arbitration. Finally, in contrast with to Italy's general arbitration act, which does not give arbitrators the power to issue interim measures of protection, arbitrators do have this power in regard

A good legislative and doctrinal approach to arbitration and arbitrability exists in Brazil where the doctrine favours both arbitration in the capital and financial markets, and in corporate arbitration in general, already permitted in the former Art. 294 of the Commercial Code, and especially after the Modification of the Law for Corporations, of 31 October 2001 (Law 10.303/2001), where article 109, paragraph 3 states that: "The company's bylaws may establish that the divergences between shareholders and the company, or between the Controlling shareholders and minority shareholders, may be settled through arbitration, under such terms as may be specified".[49] Arbitration, which from the point of view of objective arbitrability, is broadly understood in line with Article 1 of the Arbitration Law of Brazil, in such a way that it is affirmed that *all the rights inherent to the shareholder status are patrimonial, including the right to vote*,[50] and even for those authors who conclude the need to examine each situation on a case by case basis, consider there to be a general principle of arbitrability of corporate issues.[51] Among the very few exceptions considered by scholars are issues related to the nullity of decisions taken at a general meeting, due to their close connection with public order, but those relating to annulability would be arbitrable.[52]

4.2. Consumer Arbitration

In regard to arbitration agreements in consumer situations, Spanish Consumer Arbitration agreements were modified in compliance with Art. 10 of Directive 2013/11, of the European Parliament and of the Council, on Alternative Dispute Resolution for Consumer Disputes, of 21 May

to intra-corporate disputes according to Article 23 of the Spanish Arbitration Act, including the recognized possibility of issuing *ex parte* interim measures. See STJ of Cataluña, 7 April 2016 (Carlos Ramos Rubio) (No. 22/2015), considering valid an interim measure *ex parte*, something that was expressly allowed by the arbitration rules, but also considered – wrongful, in our opinion, by analogy with the powers that a judge would have under the civil procedural law.

[49] See: U. Caminha, "Arbitragem como instrumento de desenvolvimento do mercado de capitais", *Aspectos da arbitragem institucional. 12 anos da Lei 9.307/1996*, Malheiros editores 2008, 93–114; D. Andrade de Levy, "Estudo comparado da arbitragem no mercado de capitais", *Revista de Direito Mercantil, industrial, económico e financiero* 155/156/2010, 275−300, especially, 286–288, in regard to objective arbitrability.

[50] A. Goes Acerbi, "A extensão dos efeitos da cláusula compromissória nos estatutos das Sociedades Anônimas", *Aspectos da arbitragem institucional. 12 anos da Lei 9.307/1996*, Malheiros editores 2008, 189–193; D. Franzoni, *Arbitragem Societária*, Thomson/Reuters, 2015, 102–122.

[51] P. A. Batista Martins, *Arbitragem no direito societário*, Quartier Latin, 2012, 177–185.

[52] A. Goes Acerbi, 192–193. Oppositely, considering nullity issues arbitrable: P. A. Batista Martins, 204−210.

2013, 2013 O.J. (L 165/63) (EU).[53] According to the old system, pre-dispute arbitration clauses in Law 1/2007 (Art. 57.4), as well as agreements to arbitrate, contained in general conditions governed by Law 1/2007 (Art. 90), were binding for consumers if the provided arbitration system was the special consumer arbitration system created by the State and regulated under the consumer arbitral system (i.e. the one contained in Royal Decree 231/2008). Now, under the new Art. 57.4, as modified by Law 3/2014, any arbitration agreement concluded before the dispute is not binding for the consumer, but it binds the merchant if the consumer later accepts it, and when another condition is met: the arbitration agreement should meet the conditions required by the applicable laws.[54]

4.3. The exclusive jurisdiction of State the Courts

Public policy should not be confused with mandatory rules. In modern judicial application, it is clear today in Spain that even if a matter is subject to mandatory rules, it may be subject to arbitration with the obligation of arbitrators to respect those rules.[55] Whether the public order impedes the submission of a dispute to arbitration is usually a question to be decided by the law or by judicial interpretation, as the case may be.

In regard to the exclusive jurisdiction of state courts, an evolution in favour of arbitrability might be seen in Spain.[56] Generally, it is said,

[53] The general Law on Consumers (Ley General para la Defensa de los Consumidores y Usuarios, Law 1/2007) was modified by Law No. 3/2014, B.O.E., 2014, 3.

[54] Presently, Article 57 (4) of Law 1/2007, as amended by Law 3/2014, states that: "Consumer arbitration agreements other than those stipulated in this article may only be agreed on once the material conflict or dispute between the contractual parties has arisen, except in cases of submission to institutional arbitration bodies created by laws or regulations for a sector or a specific eventuality. Arbitration agreements negotiated in contravention of the provision of the preceding paragraph shall be null and void."

And for the arbitration clauses in general terms of conditions in consumer relations, see Article 90: "Terms that establish the following shall also be deemed unfair: 1. Submission to arbitration other than consumer arbitration, except where this involves institutional arbitration bodies created by law for a specific circumstance or sector." For further details, see P. Perales Viscasillas (2014), 22.

[55] For all: STSJM, 19 January 2016 (Santos Vijande) (No. 39/2015).

[56] A more restrictive view on arbitration has been adopted by certain legal systems that consider both pre– and post-dispute arbitration clauses to be invalid, because in these jurisdictions only the state courts are considered competent to hear a dispute. Therefore, arbitration as a means to solve disputes is pre-empted by imposing the exclusive jurisdiction of state courts. An example is the Code of Private International Law of the Republic of Panama (8 May 2014). Belgium is another example of a jurisdiction where legislation provides for the exclusive jurisdiction of the state courts, as well as for the mandatory application of state law in certain distribution contracts and agency contracts. Belgian case law tends to apply Article II(3) of the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards and, thus, Belgian courts have found that arbitration agreements are null and

that for reasons of legislative policy, the State may assign certain issues to a special jurisdiction. In such case, it will be the law that indicates the administrative or judicial body, other than the regular authority, that is responsible for the resolution of disputes, which will also not be able to arbitrate those matters whose resolution is entrusted exclusively to the jurisdiction or the administrative authority of the State or, likewise, there is an imperative attribution of jurisdiction.[57]

5. RECENT CASE LAW RESTRICTING OBJECTIVE ARBITRABILITY

In the area of regulated sectors, specifically the gas sector, a July 2015 decision by the Superior Court of Justice of Madrid (*Tribunal Superior de Justicia*), the competent court to decide on the setting aside of an award when the seat of the arbitration is Madrid, declared non-arbitrable a dispute between two multinational Spanish operators in the natural gas sector. The dispute arose over the system operator and carrier's refusal to renounce the reserved capacity in its contract to transport gas to France-Larrau. The Court considered this issue non-arbitrable and cancelled the partial award on arbitrability and jurisdiction, due to the need to preserve the public interest in a strategic and regulated sector. Whether a different result might have been reached in an international dispute is uncertain even with the application of Art. 9.6 of the Spanish Arbitration Act, which considers the applicable law to arbitrability under a pro-arbitration rule for international arbitrations: the matter is subject to arbitration if allowed under either the rules of law chosen by the parties to deal with the arbitration agreement, the law applicable to the contract, or under Spanish Law. Furthermore, there are no decisions in Spain denying the exequatur of an arbitral award, due to non-arbitrability of the subject-matter of the dispute under the NYC.[58] The arbitrability of disputes concerning regulated sectors is quite controversial and complex, because key institutions involved: arbitration, state justice and decision-making powers attributed to a regulatory body, in the case of Spain, the National Commission on Markets and Competition (CNMC). The following lines are not intended to address this issue completely, since arbitration of regulated sectors and the conflicts that may arise covers a very broad field, especially at an international level, including, from the disputes between regulators, between

void because of the exclusive competence of state courts. See P. Perales Viscasillas (2015), 213.

[57] STSJC 4/02/2016 (M.Eugenia Alegret) (No. 3/2014).

[58] Vicente L. Montes, "Algunas cuestiones en torno a la 'inarbitrabilidad de la diferencia' en el exequátur de laudos extranjeros", *Spain Arbitration Review* 5/2009, 13–14.

them and regulated subjects, between regulated subjects, and between any of the above and consumers. The purpose is more modest, so we will focus the analysis of the non-arbitrability of the disputes in the international transits of gas, i.e. the reduction of contracted capacity – by the STSJM, 13 July 2015 (nº 5/2015).[59] The STSJM, 13 July 2015, analyses the arbitrability nature of the disputed matter, namely the reduction of the capacity contracted at the point of departure of the international connection from Larrau, Spain to France. The STSJM makes the following considerations of interests in matters of arbitrability:

a) The court aptly referred to the point at which arbitrability should be examined, which is important since arbitrability is a variable criterion over time, hence, as indicated by the court, when Article 2 of the Law of arbitration refers to the arbitrability of the dispute places the decisive moment to define arbitrability at the moment when the claims are determined, rather than the moment when the arbitration agreement is concluded.

b) The Court rejected that the free availability enshrined in article 2.1 LA is synonymous with patrimoniality, which was actually the solution found by the arbitrators in the awarding the object of the dispute. Leaving aside the fact that the decision cannot be made automatically, the fact is that the two criteria mentioned are not identical, the question being, however, whether free availability is broader or narrower than the criterion of patrimonial matters. When dealing in both cases with indeterminate concepts, putting them into practice will be difficult.

Determining the meaning of the criterion of free availability under Spanish Law is unquestionably complex because the legal criterion is indeterminate, amorphous, elastic and unclear. It is true, as the TSJM argues, that the attribution of competence to resolve a dispute may, in line with the circumstances, clearly indicate the arbitrability or non-arbitrability of the subject matter in question. In other words, the non-arbitrability of the dispute may derive not only from the material aspect of the dispute (dispute over the conditions of use of gas infrastructure which for the Court is a matter that it is affected by public order, the general interest, and because it affects third parties rights, with the need not to confuse

[59] Comments by: L. García del Río, "Notas sobre la arbitrabilidad de disputas relacionadas con materias de derecho público a raíz de la sentencia dictada en el Asunto Larrau", *Revista la Ley Mercantil* 27/2016, 8; B. De Paz Gútiez, "Las recientes sentencias del Tribunal Superior de Justicia de Madrid en relación con la arbitrabilidad de las controversias surgidas en contratos del sector del gas natural", *Spain Arbitration Review/Revista del Club Español del Arbitraje*, 26/2016, 40; P. Perales Viscasillas, "Arbitraje y arbitrabilidad de las controversias en el sector gasista", *Revista del Club Español del Arbitraje/Spain Arbitration Review* 29/2017, 9−42.

public order with imperative rules), but also from the jurisdictional aspect of the dispute, by granting exclusive jurisdiction to a particular body, which in the case at hand is the CNMC. In the opinion of the TSJM, in the case under consideration both types of circumstances are met and thus the dispute was considered non-arbitrable, and so the partial award on jurisdiction was dismissed. For the former, the TSJM without many interpretative efforts successively lists various references and rules from EU regulations, from which, we will not deny, it derives the importance of the internal gas market, the protection and promotion of free competition, security of supply, and the benefits of regulations for consumers, among others. furthermore, if we consider the arguments expressed by the TSJM in regard to material non-arbitrability, i.e. defence of competition, security of supply, general interest, etc., we will also find that they are met in general in the gas system – and of course in many other sectors (competition law, company law and others) so that ultimately no question or controversy that could arise within them could be submitted for arbitration and this would mean leaving out contracts in the upstream sector, for example, where gas arbitration is a regular situation.[60] For the latter, it is necessary to consider that the CNMC, as a regulatory body, has two different dispute functions: administrative and arbitral. The first one is considered in article 12 (b) of Law 3/2013, of 4 June, establishing the National Market Commission and the Competition whereby it resolves disputes brought to it by economic operators in the electricity and gas markets. In this case, the CNMC resolves disputes subject to further appeal before the administrative judiciary, as opposed to the arbitration activity of the CNMC, which is entirely private in nature and thus there is no appeal against the award.

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[60] V. Ben Holland, J. Wilson, "Tailoring the arbitral process to suit natural gas Price reviews: the case for two-stage final offer arbitration", *Int. A.L.R.* 16/2013, 81−87; VVAA, *Gas Price Arbitrations: A practical handbook*, Globe Business Publishing, 2014; J. P. Wilheim, "The Arbitration Agreement and Arbitrability, The Powers of Arbitral Tribunals in Price Revision Disputes Illustrated with the Example of Long Term Gas Supply Agreements", *Austrian Yearbook on International Arbitration* 2014, 17−29; A. Mourre, "Gas Price Reopeners: Is Arbitration Still the Answer?", *Disp. Resol. Int'l* 9/2015, 139−147; M. Clarke, T. Cummins, F. Worthington, "The price isn't right – gas pricing disputes", *International Energy Law Review* 1/2015, 13−20; P. Ferrario, *The Adaptation of Long-Term Gas Sales Agreements by Arbitrators*, Wolters Kluwer, 2017.

Interesting are the statistics of the Stockholm Chamber of Commerce: "Supply contracts are the most commonly disputed gas contracts, accounting for 75% of the gas-related arbitrations administered by the SCC. 19% of the gas-related disputes have involved contracts for the exploration and development of gas fields, while 6% involved a consultancy agreement": A. Magnusson, "The SCC Experience of Gas Disputes:Perspectives from a Leading Arbitration Centre", *Second Annual Forum on Commercial & Legal Strategies for Successfully Negotiating Long Term Gas Supply Contracts*, 13–14 June 2012 Berlin, 4, *http://www.sccinstitute.com/media/30005/mag nusson_gasdisputes_thescc_experience.pdf*, last visited 6 November 2017.

Whether the CNMC functions as a court of arbitration administering the cases or as an arbitrator is highly controversial in Spain[61] and similarly abroad, because of the breach of the neutrality principle in arbitration. Recently this issue has recently been addressed, at the level of legal interpretation, by the Judgment of the High Court of Justice of Madrid (TSJM), 20 December 2016, nr. 69/2016, where the court clarifies that the arbitration function of the CNMC reaches also the function and role of an arbitrator and thus the issuing of awards. Therefore its function cannot be solely that of mere administrator of the arbitration, but can consequently act as an arbitrator. Where to define the border between conflicts that are subject to the administrative power of the CNMC and those that are subject to private arbitration is not easy to decide, and thus it will be necessary for future legislation to help provide clarity and certainty in this area.

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[61] P. Perales Viscasillas, "La función arbitral de la Comisión Nacional de los Mercados y de la Competencia", *La Ley Mercantil, Sección Arbitraje mercantil* 14/2015, 1−55; C. González Pulido, "Puede la CNMC decidir no administrar un arbitraje si las partes la han elegido como institución administradora pero considera que la disputa es no arbitrable?", *Revista Derecho Competencia y Distribución* 19/2016, 10.

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GENDER MAINSTREAMING IN LEGAL EDUCATION IN SERBIA: A PILOT ANALYSIS OF CURRICULA AND TEXTBOOKS

The general aim of this paper is to initiate a long-lasting systemic process of reviewing higher education in Serbia from a gender-sensitive point of view, and to offer initial input for building action plans and policies oriented towards this goal.

The main focus is on analyzing legal studies from a gender-sensitive point of view and on initiating gender mainstreaming within law schools. However, this paper can aspire only to modest achievements, dealing solely with preliminary research of legal studies, with a limited but a representative sample. Namely, only two accredited study programs at two public university faculties of law in Serbia – at the Faculty of Law in Belgrade and the Faculty of Law in Niš – were taken into consideration. This pilot analysis is based on an established methodology for gender-sensitive analysis of curricula as well as of syllabi and textbooks for certain legal courses. The mentioned methodology introduces specific gender-sensitive indicators as well as three categories for assessing learning outcomes of study programs, syllabi and textbooks: gender-negative, gender-neutral, and gender-sensitive. The focus of the investigation was on of the following courses: Sociology of Law, Constitutional Law, Family Law, Labor Law, and Criminal Law.

The meaning and importance of gender mainstreaming in law schools is explained in the Introduction. The normative and strategic framework for gender mainstreaming in higher education in Serbia is presented in the second chapter. The main focus of analysis – the reconsideration of curricula and textbooks from a gender perspective – is elaborated through the following three chapters: the third chapter explores the main indicators of the gender-sensitive analysis of legal education; the fourth is devoted to the analytical framework and methodology of investigation; chapter five presents the research results and their interpretation.

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The concluding notes clarify discrepancies between the normative and strategic international and national framework for gender mainstreaming of higher education, on the one hand, and the given state of affairs in Serbian legal education, on the other. The text includes recommendations for gender action plans, which could contribute to the improvement of legal and higher education in general.

Key words: *Legal education. – Gender mainstreaming. – Serbia.*

1. INTRODUCTION

In the past thirty years or so, the relevant international and national legislation and strategic documents have outlined the necessity of establishing gender equality in higher education, offering to that end formal preconditions and standards for gender mainstreaming of higher education. However, the existing higher education in Serbia and elsewhere mostly remained far from the proposed strategic aims and declared attempts, meaning that a patriarchal matrix persisted strongly in the field.

Education content and practices represent powerful instruments for reproducing current gender regimes, which have been significantly colored by the patriarchal matrix. Gender inequalities, accumulated over centuries, still permeate all spheres of public and private life, including higher education. Despite a significant number of women in the student population and academic staff, the hegemony of male academics and the patriarchal system of values in academia are still the norm.

On the other hand, education represents an important channel for transferring and promoting values of freedom, social justice and equality, as well as a significant factor for improving gender equality, understood as a crucial indicator of sustainable human development in the new millennium. Hence the obligation of education institutions in contemporary societies, especially those in transition, as is the case with Serbia, to accept and promote the idea and practice of gender equality as a basic postulate of democracy, equality and justice. Of course, the mainstreaming of gender equality in higher education requires manifold institutional, pedagogical, and education changes.

Gender equality is a complex and multidimensional concept, with multiple and sometimes controversial conceptions. Due to different articulations of the nature and purpose of gender equality,[1] this concept has different definitions in literature and legal documents.[2] In our analy-

[1] Gender Equality Index Report, European Institute for Gender Equality, 2013, *http://eige.europa.eu/sites/default/files/documents/Gender-Equality-Index-Report.pdf*, last visited 10 October 2017.

[2] Gender mainstreaming – Conceptual framework, methodology and presentation of good practices, Final report of activities of the Group of Specialists on Mainstreaming,

sis, we use the definition that gender equality means equal access for all persons, irrespective of gender, to all spheres of social and private life, as well as their equal status and opportunities to exercise basic rights and reap equal rewards from the output.[3]

Gender mainstreaming of higher education is especially important in the case of law schools, because the creation and implementation of law depends on the competences of lawyers. Given that legal rules represent a fundamental instrument for enacting gender equality policy,[4] the education of lawyers has been one of the most important factors in implementing this policy in all spheres of social relations. In that regard, the words of Harvard Law School Professor Felix Frankfurter, spoken in 1927, still hold true: "In the last analysis, the law is what the lawyers are. And the law and the lawyers are what the law schools make them."[5]

Gender mainstreaming of legal education requires, among other things, reconsidering study programs of all faculties of law in general, and syllabi and textbooks for individual courses, all from the point of gender-sensitive content and language, ensuring formal preconditions for better gender balance in academia, overcoming gender stereotypes and prejudices among professors and students when interpreting legislation or particular legal fields, concrete laws, case law, as well as considering the multidisciplinary dimension of legal education.

The necessity of a gender-sensitive approach in legal education emerges also from the highest value and normative standards of modern international and national law. Educating students of law (future lawyers, judges, prosecutors, administrative workers, members of parliament and government bodies) in a gender-sensitive manner means a real investment in better legislation and a more correct interpretation and implementation of law. It also means an investment in a better future by sensitizing judges in particular, but also legal professionals in all fields of legal practice.

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http://www.unhcr.org/3c160b06a.pdf, last visited 10 October 2017; European Commission, One hundred words for equality: A glossary of terms on equality between women and men, *http://www.eduhi.at/dl/100_words_for_equality.pdf*, last visited 10 October 2017; Strategy for equality between women and men 2010–2015, EC, 2010, *http://ec.europa.eu/justice/gender-equality/document/index_en.htm*, last visited 10 October 2017.

[3] Definition of gender equality in National Strategy on Improvement of Women Status and Gender Equality for the Period 2016−2020, *http://socijalnoukljucivanje.gov.rs/en/the-national-strategy-for-gender-equality-until-2020-adopted/*, last visited 10 October 2017.

[4] M. Pajvančić, N. Petrušić, "Značaj institucionalnih mehanizama za ostvarivanje rodne ravnopravnosti", *Zbornik Pravnog fakulteta u Nišu* 67/2014, 26.

[5] Letter from Felix Frankfurter, Professor, Harvard Law School, to Mr. Rosenwald (13 May 1927), quoted in B. P. Elman, "Creating a culture of professional responsibility and ethics: a leadership role for law schools", *http://www.lsuc.on.ca/media/eighth_colloquium_ professional_responsibility ethics.pdf*, last visited 10 October 2017.

This serves the fulfillment of the essence of contemporary law – equal respect and protection for all individuals.[6]

The aspects of law school most in need of a comprehensive revision through gender sensitivity are the following: gender dimensions of curricula, syllabi and textbooks, the "hidden curricula" (educational and social setting), the status of women in academic and research staff, as well as in upper management, the gender quality of scientific research projects, vertical and horizontal segregation of academic staff and students, and the role and activity of female members in student organizations and in faculty government bodies. Proper attention should also be paid to the language of education. Nevertheless, the quality of the curricula and textbooks is crucial for enacting educational aims.

Here we present the results of an exploratory analysis of gender dimensions of the undergraduate legal study programs (curricula) at the faculties of law in Belgrade and Niš, as well as the syllabi and textbooks for their most relevant courses, based on the explained methodology.

2. THE NORMATIVE AND STRATEGIC FRAMEWORK FOR GENDER MAINSTREAMING OF HIGHER EDUCATION IN SERBIA

Based on international normative and strategic documents, gender mainstreaming of higher education represents a strategic aim of the Serbian state and society. These documents could be considered as inherently progressive, because they strive toward a representation of civilizational standards of universal equality applied to the gender issue, while acknowledging the right to differences between gender identities. The appearance of international and national legal and policy mechanisms for women`s rights represents a great historical achievement of recent history: it encompasses half of humanity and incorporates all other expressions of complex coupling of universal equality, the right to equal opportunities and the right to difference.

2.1. The Normative Framework

The normative framework consists of international and national rules, which guarantee gender equality, forbid gender-based discrimination, and define the obligations of the state and its bodies with regard to gender equality policy.

[6] D. Vujadinović, "Country Report on Legal Perspectives of Gender Equality in Serbia", *Legal Perspectives of Gender Equality in Southeast Europe* (eds. F. Kola-Tafaj *et al*.), SEELS, Skopje 2012.

At the international level, the Convention on the Elimination of All Forms of Discrimination Against Women (CEDAW)[7] is crucial. This document, among other things, proposes state obligations to ensure equality for both women and men in the field of education.[8] Special focus is put on the elimination of stereotyped conceptions of male/female roles at all levels and forms of education, especially by revising textbooks, study programs, educational methods, etc.[9]

Regarding equal rights to education, the main international document is the International Covenant on Economic, Social and Cultural Rights,[10] which guarantees the right to education, forbids discrimination on any grounds (including gender),[11] and proposes the obligation that member states ensure the right to education for all men and women.[12]

Numerous declarations and recommendations are also part of the internationally relevant framework for gender mainstreaming of higher education.[13]

The Beijing Declaration[14] and Platform for Action[15], adopted at the Fourth World Conference on Women in 1995, states that study programs and teaching materials are still significantly under the influence of gender discrimination, which reinforces traditional male and female roles. The lack of awareness about gender equality among teachers at all levels of education reproduces and reinforces existent gender inequality and simultaneously stimulates discriminatory tendencies.[16]

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[7] Convention on the Elimination of All Forms of Discrimination against Women (CEDAW), General Assembly Resolution 34/180, 18 December 1979. The convention was ratified by the SFRY (*Official Gazette of the SFRY – International Treaties*, No. 11/81), and it was valid in the FRY and the Serbia and Montenegro state union on the basis of succession. It is valid in the Republic of Serbia on the same basis.

[8] General Recommendation No. 28 on the Core Obligations of States Parties under Article 2 of the Convention on the Elimination of All Forms of Discrimination against Women, CEDAW/C/GC/28, par. 5.

[9] CEDAW, Article 10.

[10] International Covenant on Economic, Social and Cultural Rights, General Assembly Resolution 2200A (XXI), 16 December, 1966. The convention was ratified by the SFRY (*Official Gazette of the SFRY – International Treaties*, No. 7/71), and it was valid in FRY and the Serbia and Montenegro state union on the basis of succession. It is valid in the Republic of Serbia on the same basis.

[11] Article 2 of the International Covenant on Economic, Social and Cultural Rights.

[12] Article 3 of the International Covenant on Economic, Social and Cultural Rights.

[13] N. Petrušić, S. Konstantinović Vilić, "Modeli rodne senzitivizacije obrazovanja pravnika/pravnica", *Prava dece i rodna ravnopravnost − Između normativnog i realnog*, Pravni fakultet, Istočno Sarajevo 2012, 426−430.

[14] *http://www.un.org/womenwatch/daw/beijing/platform/declar.htm*, last visited 10 October 2017.

[15] *http://www.un.org/womenwatch/daw/beijing/platform*, last visited 10 October 2017.

[16] This Platform aims to develop education with no discrimination, and compel governments and education bodies and institutions to elaborate on the recommendations

The 2007 Council of Europe Recommendation on gender mainstreaming in higher education[17] asserts that education for democratic citizenry contributes to the promotion of the principle of gender equality and encourages the creation of peaceful and harmonious human relations. It also points to the need for a gender dimension in study program contents to eradicate sexist stereotypes and prepare young people for gender partnerships in both their private and public lives. Additionally, recommendations are made to states on how to influence authors and publishers of teaching materials to become aware of the importance of gender equality, as a qualitative criterion for the creation and selection of material.

The World Declaration on Higher Education for the Twenty-First Century[18] recommends the elimination of gender stereotypes in higher education, taking into consideration gender dimensions in different scientific disciplines, active participation of women in educational institutions at all levels of work and in all disciplines, especially in the scope of decision making.[19]

Gender mainstreaming of higher education represents an important element in establishing the European Higher Education Area, defined by the so-called Bologna Declaration,[20] which, among other things, encompasses education for gender equality, peace and tolerance.[21]

The legal basis for gender mainstreaming of higher education at the national level is, firstly, the 2006 Constitution of the Republic of Serbia.[22] It forbids any form of discrimination of groups or individuals on the basis of any personal feature,[23] and opens space for introducing special measures for conducting factual equality for discriminated groups or individuals. Particularly important are the provisions that ensure equality between

and create study programs, textbooks and other tools without gender stereotypes for all levels of education, including education of educators. *Ibid.*

[17] Recommendation CM/Rec(2007)13 of the Committee of Ministers to member states on gender mainstreaming in education and explanatory memorandum, *http://www.coe.int/en/web/genderequality/gender-mainstreaming-at-the-council-of-europe*, last visited 10 October 2017.

[18] World Declaration on Higher Education for the Twenty-First Century, Vision and Action, UNESCO, Paris 1998, *http://www.unesco.org/education/educprog/wche/declaration_eng.htm*, last visited 10 October 2017.

[19] D. Popović, D. Duhaček, "From the Zurich Circle to Gender Studies: Gender Equality and Higher Education in Serbia", *Godišnjak Fakulteta političkih nauka*, Beograd 2009, 688.

[20] The European Higher Education Area – Joint Declaration of the European Ministers of Education, *http://www.magna-charta.org/resources/files/BOLOGNA_DECLARATION.pdf*, last visited 10 October 2017.

[21] D. Popović, D. Duhaček, 689.

[22] *Official Gazette of the RS*, No. 98/2006.

[23] Art. 21 of the Constitution of the Republic of Serbia.

women and men. They obligate the state to promote a policy of equal opportunity,[24] and to that end use appropriate measures for eliminating (factual) inequality between women and men, and create circumstances in which both sexes enjoy their guaranteed rights under equal conditions.

Prohibition of gender-based discrimination is proposed by the general anti-discrimination law – the 2009 Law on the Prohibition of Discrimination in the Republic of Serbia, which considers gender-based discrimination as a special form of discrimination.[25]

Gender-based discrimination is also considered in a special anti-discrimination law – the 2009 Law on Equality Between Sexes, which requires governmental bodies to pursue active policies of equal opportunities in all spheres of social life,[26] including education.[27] This law explicitly prescribes the duty for education institutions to ensure that study programs include education on gender equality for the sake of overcoming gender-based restrictions in roles, as well as gender-based stereotypes and prejudices. It also proposes an obligation that study programs, standards for textbooks, and educational methods be framed in a way that leads towards a policy of equal opportunities for men and women.[28] The new Law on Gender Equality is currently being drafted.

The Law on Higher Education in the Republic of Serbia[29] also prohibits gender-based discrimination by way of principles of higher education, which include respect for human rights and prohibition of all forms of discrimination.

2.2. The Strategic Framework

Improvement of gender equality and suppression of gender-based discrimination represent strategic aims of the Serbian state, which is constitutionally defined as a social state based on human rights, rule of law and European principles and values.[30] The crucial strategic document, which defines an all-encompassing system of measures and activities for

[24] Article 15 of the Constitution of the Republic of Serbia.

[25] Article 20 of the Law on the Prohibition of Discrimination in the Republic of Serbia; N. Petrušić, I. Krstić, T. Marinković, *Komentar Zakona o zabrani diskriminacije*, Službeni Glasnik, Beograd 2016, 155−156.

[26] Article 3 of the Law on Gender Equality.

[27] M. Pajvančić, N. Petrušić, S. Jašarević, *Komentar Zakona o ravnopravnosti polova*, Centar Modernih veština, Beograd 2010, 76−77.

[28] Article 32 of the Law on Equality Between Sexes.

[29] *Official Gazette of the RS*, No. 76/2005, 100/2007 – authentic interpretation, 97/2008, 44/2010, 93/2012, 89/2013, 99/2014, 45/2015 – authentic interpretation, 68/2015 and 87/2016. In late September 2017, the Serbian Parliament adopted the Law Amending the Law on Higher Education, which contains no new solutions relevant to this issue.

[30] Article 1 of the Constitution of the Republic of Serbia.

pursuing a policy of gender equality, is the National Strategy for Gender Equality 2016–2020 and the accompanying Action Plan 2016–2018.[31] Gender-sensitive education is one of the document's special targets within the first strategic aim called "Changed Gender Patterns and Improved Culture of Gender Equality." This Strategy starts from the Concluding Remarks of the CEDAW Committee relevant to Serbia, which point to persistent gender stereotypes in educational materials and textbooks, and concludes on its own behalf that study programs and educational materials at all levels of education are not gender-sensitive.[32] Certain measures are proposed in this Strategy for gender mainstreaming of education in general, some of which are especially relevant to higher education.[33] Further, there is a proposition of a strategic aim to establish Gender Studies at the undergraduate and postgraduate levels, to the highest extent possible.

The Strategy for Prevention and Protection against Discrimination 2013–2018,[34] points to the absence of gender-sensitive content in textbooks and study programs. Changing the traditional patriarchal stereotype is proposed as a general aim, and its particular aim is for all study programs to become gender-sensitive and include content about unacceptability of discrimination and gender stereotypes.

In spite of the fact that educational content and practices represent very powerful instruments for gender mainstreaming of education and all spheres of public and private life, the issue of gender inequality is neither problematized in the Strategy for Education Development in Serbia (2012–2020), nor can it be found among the strategic aims.[35] This Strategy insofar belongs to the scope of gender-blind state documents. By contrast, the Strategy of Scientific and Technological Development of the Republic of Serbia 2016–2020 – "Research for Innovation",[36] includes gender-equality improvement as one of six measures that will ensure excellence and expertise in science.

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[31] *Official Gazette of the RS*, No. 4/2016.

[32] The same statement was present also in the previous strategy for the period 2009−2015.

[33] The following measures are: introducing obligatory gender-sensitive and anti-discriminatory study programs and educational contents at all levels of education, including education of adults and education of media professionals; revision of education content and textbooks with view to eliminating gender stereotypes, discriminatory content and language; advancement of competences of educators through their education regarding gender equality; introducing gender sensitive language in all educational content; introduction of knowledge about female contribution to science, culture and art.

[34] *Official Gazette of the RS*, No. 60/2013.

[35] *Official Gazette of the RS*, No. 107/2012.

[36] *Official Gazette of the RS*, No. 25/2016.

3. GENDER ANALYSIS AND GENDER-SENSITIVE INDICATORS FOR ASSESSING LEGAL EDUCATION

Law schools, and higher education in general, have three crucial roles: education, scientific research, and support of social development.[37] The main aims of legal education are to prepare students for the legal profession at a high level of competence, to become fully devoted to justice and fairness, as well as to imbue the highest ethical standards, common good and full respect for human dignity. Additionally, legal education has the aim to prepare students for living, studying and working in pluralistic, multicultural and globalized surroundings.

In our analysis, we start from the premise that institutions of higher education in general, and law schools in particular, will fulfill their obligation, prescribed by the normative and strategic documents of the Serbian state, to act in accordance with the policy of gender equality and make a systemic effort for its accomplishment. Consequently, we also start from the premise that faculties of law will fulfill their obligation to integrate gender perspectives into study programs that define why, what, and how is to be studied,[38] and to reconsider and revise all textbooks in a gender-sensitive manner.[39]

The assessment of gender perspectives of legal education supposes an all-encompassing reviewing of all its elements: its study programs, educational circumstances, and human resources.

Regarding inherent features of particular samples of legal education, there are a several crucial indicators for assessing the level of their gender mainstreaming.

The first indicator is *gender sensitivity of study programs*. Education programs are the engine of secondary socialization, i.e. the main possible creators and promoters of gender stereotypes.[40] It is, therefore, necessary to consider the gender dimensions of all the elements of study programs.

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[37] The Magna Charta Universitatum, the document signed by 388 rectors and heads of universities throughout Europe on 18 September 1988, on the occasion of the celebration of the 900th anniversary of the University of Bologna, *http://www.magna-charta.org/magna-charta-universitatum/the-magna-charta-1/the-magna-charta*, last visited 10 October 2017.

[38] M. Vukasović, *Razvoj kurikuluma u visokom obrazovanju*, AAOM, Dosije, Beograd 2006, 25.

[39] J. Baćević *et al*., *Analiza rodne dimenzije u visokoškolskom obrazovnom materijalu*, Program Ujedinjenih nacija za razvoj (UNDP), Sektor za inkluzivni razvoj, Beograd 2010.

[40] J. Mertus, Z. Mršević, M. Dutt, N. Flowers, *Ženska ljudska prava − Praktična implementacija*, Beograd 1995, 16.

The second indicator is *gender sensitivity of textbooks*, because they are the main educational means and sources of knowledge about social and legal phenomena and institutes. Therefore, their gender analysis is of crucial importance for assessing gender sensitivity of legal education.[41]

The third indicator is the so-called *hidden curriculum*, which is related to the extent of presence of the patriarchal matrix in the educational context.[42] This concept refers to a social setting and unwritten rules in pedagogical approaches and social relations within education, which often reproduce patriarchal patterns.[43] Lecturers and students interpret social and legal phenomena through lectures, seminars, practical work. Their internalized gender stereotypes often contribute to the patriarchal matrix within the education and pedagogic process. Different systems of values, including patriarchy, influence formal and informal contacts and relations between lecturers and their students, as well as among students, and this also represents a kind of knowledge to which students are exposed in the educational institution[44] and its organizational culture.[45] Indicators that belong to the "hidden curriculum" are: value statements of lecturers, students and decision-makers regarding gender roles and gender equality; the level of existing gender-based discrimination and harassment, including sexual harassment between teachers and students, among teachers, and among students; the existence and practical efficacy of instruments for preventing and sanctioning gender-based discrimination and gender-based harassment.

The fourth indicator concerns *gender balancing of human resources*, with issues of equal opportunities for women to take part in lecturing, scientific and research processes, and for their career promotion.

The fifth indicator is related to *quantitative gender balance in the academic staff and student population,* including the analysis of vertical and horizontal segregation: the gender structure of the academic staff, top management and governmental bodies; the gender structure of the student population, members and leadership of student organizations, and of stu-

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[41] D. Stjepanović-Zaharijevski, D. Gavrilović, N. Petrušić, *Obrazovanje za rodnu ravnopravnost, Analiza obrazovnih materijala za osnovnu i srednju školu*, Mena Group, UNDP, Beograd 2010, 14.

[42] Stjepanović-Zaharijevski *et al*., 97.

[43] I. N. Jarić, *Javni i skriveni kurikulumi srednjoškolske nastave sociologije: Obrazovne reforme u Srbiji 1960–2006*, doktorska disertacija, Filozofski fakultet Univerziteta u Beogradu, Beograd 2012, 21.

[44] P. Georgievski, "Sociologija obrazovnih programa", *Sociološki rečnik* (eds. A. Mimica, M. Bogdanović), Beograd, 549. See also: N. I. Jarić, 19.

[45] A. Ramštek, Rodna ravnopravnost, priručnik za predavače, Ministarstvo inostranih poslova Republike Slovenije, iv, *http://www.ijp.rs/uploads/editor /joined_document.pdf*, last visited 10 October 2017.

dent representatives in the governing institutional bodies; the status of women in career promotion within the academic and research field of work. Gender-sensitive statistics are an unavoidable part of this framework of consideration.

Given that higher education has been inseparable from scientific research, it is necessary to also reconsider the *gender sensitivity of scientific legal research* projects, from the perspective of their content and distribution of male and female positions in research teams.

Together, these indicators comprise a framework for implementing a substantive gender analysis,[46] which encompasses insights into proposed female/male social roles, with differences in conditions, needs, representation, availability of sources, access to development, as well as in controlling and decision-making power, etc. Gender analysis indicates whether the concerned mode of education contributes to overcoming gender-biased social roles or not.

4. PILOT ANALYSIS: ANALYTICAL FRAMEWORK AND IMPLEMENTED METHODOLOGY

We have applied this method of gender analysis for reconsidering legal education from the point of national strategic aims related to gender equality policy in the field of education. Our investigation is of an explorative, preliminary character: the pilot analysis is the most efficient way for generating hypotheses and defining propositions and guidelines for future comprehensive research. Due to limited resources, only two crucial educational elements/indicators will be the subject of this gender analysis: study programs of undergraduate legal studies, and textbooks as primary educational resources for certain legal courses. The research sample consists of two accredited legal study programs, which belong to two public universities in Serbia. Most students who graduate with a law degree in Serbia are alumni of these universities.[47] The sample also includes select textbooks for certain key legal courses.

The gender analysis of undergraduate study programs has to answer to the question whether the gender perspective is present and to what extent. Therefore, the subject of our investigation were all elements of study programs: structure, purpose, aims, anticipated competences,

[46] One hundred words for equality: A glossary of terms on equality between women and men.

[47] There are thirteen accredited higher education institutions in Serbia where the title of Bachelor of Law can be taken. Six are publicly funded, while seven of these faculties have been founded by legal and private entities, in accordance with Art. 40 of the Law on Higher Education.

lists and structure of mandatory and optional courses, as well as their proposed aims, learning outcomes, and contents.

We collected data by applying the quantitative and qualitative method in our search for the answers to the following questions:

1) Is acknowledging/understanding of gender dimension of legal education proposed as a learning outcome?
2) Is Human Rights a course unto itself, and if so, does it have an optional or mandatory status? This implies that the existence and status of this course indicates *per se* the merit of openness of the study program for developing legal education around human rights. A further implication is that sensitivity of a study program for law on human rights represents a solid basis for further steps towards a gender-sensitive approach, even if the Human Rights course may not have been gender-sensitive at the given moment.
3) Is Gender Studies a course unto itself and with what status?
4) Are gender dimensions of social and legal concepts and institutes mentioned and to what extent in the syllabi of certain courses?
5) How many topics overall have been interpreted through the gender perspective?

The collected data allowed for the classifying of study programs into one of the following categories: gender-negative, gender-neutral, and gender-sensitive. In this categorization, "gender-negative" are study programs that contain an explicit affirmation of stereotyped gender roles and gender discriminatory attitudes; "gender-neutral" are ones that do not contain explanatory topics of gender aspects of social and legal phenomena and institutes, and insofar are "gender blind". "Gender-sensitive" is the program that recognizes and adequately interprets gender dimensions of social and legal phenomena and institutes, and also recognizes inequalities produced by the application of gender-neutral legal norms.[48]

When textbooks are concerned, we applied the following approach for creating the sample: first, we assessed the list of most important gen-

[48] In the Netherlands universities report gender-sensitive contents of study programs according to four classifying categories: 1) program is gender-oriented; 2) program contains obligatory components on gender issues; 3) opting for non-obligatory modules on gender issue is available; 4) program does not have gender orientation. (M. Langeveld, C. Vijfhuizen, M. Gondwe, Complexities of gender mainstreaming in higher education capacity development programmes, The Dutch organisation for internationalisation in education, 2012, 14, *https://www.nuffic. nl/en/publications/find-a-publication/complexities-of-gender-mainstreaming-in-higher-education-capacity-development-programmes. pdf*, last visited 10 October 2017.

der relevant topics (concepts and phenomena), which will represent units of introspection and together comprise the analytical framework of research. They are: 1) gender equality 2) gender stereotypes and prejudices 3) discrimination – structural and individual, 4) political representation of women, 5) special measures favoring deprived social groups, 6) balancing of professional and family life, 7) marriage, 8) extra-marital community, 9) same-sex partnerships, 10) parenthood, 11) reproductive rights, 12) rights of LGBT persons, 13) gender-based violence, 14) crimes based on gendered hatred, 15) gender (in)sensitivity of the textbook language. In accordance with selected topics, we created a list of the obligatory courses that would most directly deal with these topics: Sociology of Law, Constitutional Law, Family Law, Labor Law, and Criminal Law. Then we collected information from official course syllabi regarding mandatory reading, forming a sample of twelve textbooks. It is interesting to note that only one of these textbooks had a female author.

We first investigated whether these textbooks consider expected gender-relevant topics or not, and then paid attention to the parts of the texts in which they were taken into consideration. We applied qualitative analysis to those units and investigated the scope and significance given to gender-relevant topics compared to others, the way they were explained and linked to other topics, the scope in which gender stereotypes were eventually considered, and how new gender-sensitive legislative solutions – regarding female political participation, protection from gender-based discrimination and gender-based violence – are interpreted in them. Insights gained this way represent the basis for conclusions about the level of gender-sensitivity of textbooks, as well as their categorization as gender-negative, gender-neutral, or gender-sensitive. We applied the same criteria to the categorization of textbooks as to study programs.

5. RESEARCH RESULTS AND THEIR INTERPRETATION

5.1. Study Programs

The undergraduate study program of the University of Belgrade Faculty of Law[49] consists of 76 courses, which have been distributed over four academic years, and of which 24 are obligatory courses for all stu-

The results of this research also indicate that of the 676 study programs in 2011, 22% (149) included obligatory gender-related elements and modules, 19% (129) offered optional gender-related modules and 59% (398) did not include a gender orientation.

[49] Accredited study program of undergraduate studies at the Faculty of Law University of Belgrade – Decision on Accreditation, Ministry of Education, Science and Technological Development, Committee for Accreditation of Scientific-Research Organizations, No. 021-01–17/61, 12. 3. 2013, Belgrade.

dents, 20 obligatory for specific modules,[50] and 32 courses from the third and fourth academic year have optional status.[51] Additionally, there are six Skills included in this legal study program.

In this study program there is no mention of gender dimension of law, neither in the description of purpose and aims, nor in the competences proposed to be attained during the undergraduate study of law. The stated purpose of this study program is to enable students to implement law, as well as to creatively and critically consider problems of application and production of legislation, and ensure that their further work is in accordance with the rule of law. A further purpose of this study program is to respond to the need of contemporary legal education and legal professionals to successfully deal with contemporary social challenges, while also preserving respect and connection with the values articulated over many decades. For the creation of the aims of this study program, the Faculty cites competitiveness and harmonization with the Bologna Declaration: it seeks to be "a true representative of the European system of higher education." As for the competences, the students ought to achieve the necessary ability to understand, interpret, explore and apply legal knowledge, necessary for the processes of European integration, especially in the case of Serbia's accession. However, it is evident that knowledge and understanding of gender dimensions of legal studies and professionalism is not mentioned in these principle proposals, nor has it been defined as any learning outcome of this undergraduate study program of law.

When the Human Rights course is concerned, it is one of the obligatory courses for the international law module, e.g. obligatory in the third academic year for students who opted for this module, but is not obligatory for all students of undergraduate legal studies.

The gender studies course is included in this study program, with the title Gender Law, and has the status of an optional course at the third academic year. It is one of 18 optional courses, offered last on the list.

In analyzing the syllabi for particular courses and their defined aims, learning outcomes and content, we intended to gain insights into whether they include gender aspects of social and legal phenomena and institutes, and if so, in what way and to what extent.

The collected data shows that of the 78 courses, there are only 11 (including Gender Law), that encompass phenomena and institutes dealing with the gender dimension. However, as a rule, the gender dimensions

[50] From the second academic year students opt for one of four educational thematic groups, and four courses from the opted educational group then become obligatory.

[51] There are 18 courses on the list of optional courses offered in the third academic year, and 14 in the fourth academic year. Each student chooses one optional course for the third and fourth year of his/her studies, each, i. e. two optional courses in total.

have not been considered in a gender-sensitive manner. For example, in the syllabus for Sociology of Law, which is an obligatory course for all students of the first academic year, there are noted gender relevant topics such as "Social Reproduction and Legal Regulation", "Contemporary Marriage", "Family and Family Law", "Social Relations and Rights of Generations and Genders", "Social Inequalities and Law". However, there are no indications regarding the gender-sensitive dimension of these topics or any others within the content of this syllabus, as well as regarding the aims and outcomes of the given course. The situation is similar in the case of other syllabi.

As a conclusion, there are certain gender-relevant topics within the syllabi of the considered study program, although in relatively small numbers. However, these gender-relevant topics are not considered in a gender-sensitive manner and nowhere in the syllabi is there any mention of an intention to interpret them from a gender perspective. The only exception is the syllabus for Gender Law, in which all the topics are presented in a gender-sensitive manner.

According to the criteria for assessing the level of gender mainstreaming in study programs, the one in Belgrade belongs to the gender-neutral category.

The study program at the University of Niš Faculty of Law,[52] includes 72 courses, of which 24 are obligatory; 48 have optional status and are divided into four lists, one for each academic year. The descriptions of structure, purpose, aims, competences do not include any mention of a gender dimension of law, nor is the knowledge and understanding of it defined in the learning outcomes.

Human Rights does not exist in the curriculum as a separate course.

There is a course, Legal Gender Studies, as one of 17 optional courses in the third academic year.

An insight into the syllabi reveals that of the 72 courses, only 14 courses contain topics (phenomena and institutes) with inherent gender features. The collected data also clearly indicate that there is no syllabus, with even an attempt to consider topics in a gender-sensitive manner, even when topics with direct gender features and dimensions are mentioned in them. For example, in the syllabus for International Public Law, an obligatory course of the second academic year, there are topics related to human rights (though labelled inappropriately "rights of men"), and mentioned are "children's rights" and "rights of disabled persons" and international treaties related to them; however, women`s human rights and the UN CEDAW Convention related to them are not mentioned.

[52] Accredited study program of undergraduate studies at the University of Niš, Faculty of Law, *http://www.prafak.ni.ac.rs/files/studije/Studijski-program-osnovnih-akademskih-studija-prava-iz-2013.pdf*, last visited 10 October 2017.

The only exception, again, is the syllabus for Legal Gender Studies, in which all topics are considered in a gender-sensitive perspective.

5.2. Textbooks

In the selected textbooks[53] we examined whether gender-relevant concepts and phenomena exist or not. Where we found their existence, the next step of our investigation was to test whether they were considered in a gender-sensitive way and how much significance has been given them in an overall comparative perspective. Then we also investigated the presence or absence of gender stereotypes, as well as whether new legislative gender-sensitive solutions have been present in these textbooks, and if so – how they are interpreted.

The aim of our pilot analysis was to offer a methodological and analytical framework for a particular and comparative gender analysis of any textbook. Hence a summary analysis of these textbooks will be presented primarily and particular textbooks and their authors will not be referred to extensively here, but only in a few exemplifying cases. In our opinion, the announcing of detailed research results concerning the contents of particular textbooks, a delicate task *per se*, would be much more appropriate for a future comprehensive research project, which would carry out a gender analysis of all the textbooks included in the accredited legal study programs in Serbia. Even Europe-wide projects aiming at all higher education textbook analysis from a gender-sensitive point of view would be of a great importance, not only for research aims but also for improving gender mainstreaming of higher education in Europe and beyond.

Textbooks for Sociology and Sociology of Law do have more or less gender-sensitive explanations for the most referential gender-sensitive topics. However, all other topics are written in a gender-neutral way, even if they have an inherently gender dimension. Gender-sensitive analyses cover not more than 10% to 15% of the content. New gender-sensitive laws are not mentioned. Gender insensitive language is used.

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[53] S. Bovan, *Osnovi sociologije prava*, Pravni fakultet Univerziteta u Beogradu, Beograd 2017; M. M. Mitrović, D. S. Vuković, *Uvod u sociologiju prava*, Pravni fakultet Univerziteta u Beogradu, Beograd 2016; R. Marković, *Ustavno pravo*, Pravni fakultet Univerziteta u Beogradu, Beograd 2017; D. M. Stojanović, *Ustavno pravo*, Sven, Niš 2013; Z. Ponjavić, *Porodično pravo*, Službeni Glasnik, Beograd 2017; M. Draškić, *Porodično pravo i prava deteta*, Pravni fakultet Univerziteta u Beogradu, Beograd 2015; S. Panov, *Porodično pravo*, Pravni fakultet Univerziteta u Beogradu, Beograd 2015; P. Jovanović, *Radno pravo*, Pravni fakultet u Novom Sadu, Novi Sad 2012; B. Lubarda, *Radno pravo*, Pravni fakultet Univerziteta u Beogradu, Beograd 2012; Z. Stojanović, N. Delić, *Krivično pravo, Posebni deo*, Pravna knjiga, Beograd 2017; D. Jovašević, *Krivično pravo, Posebni deo*, Nomos, Beograd 2006.

Most of textbooks for Family Law are gender-neutral.[54] In some of them, certain topics, which have a gender dimension, are interpreted in a gender-sensitive way,[55] although in the final score, they also belong to gender-neutral textbooks.[56] However, there is the textbook[57] which contains implicitly or explicitly particular gender-negative statements; more focus in analysis of marriage is given to religious dogmas about marriage than to legislative norms of contemporary family law; a negative viewpoint of principle of gender equality[58], as well as of homosexual partnership and legal protection of homosexual rights is presented,[59] and the right to abortion has been even called into question; negative critique of the Law on Preventing Domestic Violence[60] is presented;[61] there is no explanation of the gender basis of domestic violence, indeed, the explanation offered is even gender-negative.[62]

[54] M. Draskić, M. Z. Ponjavić.

[55] Draškić points to the gender dimension of domestic violence and accentuates that victims of this sort of violence mostly are women and children. She also explains legal obligation of states to secure efficient protection from domestic violence. (*Ibid.,* 54–60)

[56] For example, Draškić explains the principles of family law, among which are the principle linked to the free decision-making related to giving birth to a child and the principle related to forbidding discrimination; from a gender-equality point of view the statement that the right to free decision-making to give birth represents a "constitutional right of men" (22) is controversial, as well as that the norm that recognizes the right of women to make decision in this regard is contrary to Constitution and international documents on human rights (22, fn. 41). When the principle of forbidding discrimination is concerned, controversial is mentioning of the right of women to abortion, as an example for cases in which the principle of gender-equality, i.e. equal opportunities, equality in legal rights and duties for male and female citizens is not exercised and men are harmed. (23). Ponjavić, for example, promotes arguments of pro-life social movements that in the case of conflict between the rights of mother to her body integrity and the right of fetus to live priority shall be given to the fetus' right (67). He also argues in favor of a legal ban on marriage between mentally disabled persons, with an argument that society thusly protects itself from "population degeneration" (118), and when he explains the aim of marriage he speaks about "normal satisfying of the sexual drive (104).

[57] S. Panov.

[58] "The main complaint against the principle of gender-equality stems from its inability to satisfy the legitimate and different needs of spouses, which are expressions not only of their *collective* features, based on sexual identity, but also of their individual features based on different preferences, sensibilities, inclinations towards a cultural model or personal axiology." S. Panov, 10.

[59] *Ibid.,* 62−73.

[60] *Official Gazette of the RS*, No. 94/16.

[61] S. Panov, 393−399.

[62] In the chapter "Protection Against Domestic Violence", contested, as potentially harmful, are the legislative solutions proposed to prevent this type of violence. S. Panov, 379−412.

In the textbooks for Constitutional Law, the constitutional guarantee of gender equality and policies of equal opportunities (declared for the first time in the 2006 Constitution) is not given a proper theoretical interpretation. Most topics do not have a gender dimension; where present, they are interpreted in a gender-neutral way. A few topics do have a gender dimension, although not interpreted properly: proper explanations of policies of equal opportunity is absent, as well as differentiation between formal and substantive equality; the purpose of special affirmative measures is not explained, including those proposed for political participation of women; the language used is gender insensitive. Women are sometimes referred to by an offensive and clichéd formulation "the weaker sex."[63]

One of the textbooks for Labor Law[64] does indeed contain a significant amount of gender-sensitive content. There is also emphasis on the feminist movement's contribution to the development of labor law.[65] The principle of equality in employment and work is considered in a gender-sensitive manner, with strong emphasis on the principle of equal opportunities and gender-based discrimination and its prohibition. In discussing gender-based discrimination, the textbook points out that it primarily refers to women, but sometimes also men and transsexual persons. Considering harassment at work, the issue of the victim's gender is neglected. There are a few examples of gender-sensitive language in this textbook.[66] However, ultimately, this textbook, although less than others, also belongs to textbooks written in a gender insensitive and gender-neutral manner.[67] Another textbook points out a smaller presence of women in certain professions and to a necessity for policy measures of so-called positive discrimination, although the author does not explain the causes of the given factual disbalance.[68] This textbook is mostly gender-neutral, though also with examples with wrongly interpreted certain institutes, such as sexual harassment (as not being gender-based discrimination[69]) or parental leave (as the fathers` right which can only be exercised if the mother cannot exercise her right or is unemployed).[70]

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63 D. M. Stojanović, *Ustavno pravo*, Sven, Niš 2013, 155.

64 B. Lubarda.

65 B. Lubarda, 43.

66 In his textbook Lubarda uses the Serbian notion "employed" in a male and female alteration. B. Lubarda, 23.

67 When standard institutes of labor law are on agenda, they are considered in a gender-neutral way, although there are cases in which gender-sensitive approach would be necessary, such as in the case of career promotion and gender pay gap.

68 P. Jovanović, 126.

69 *Ibid*., 261.

70 *Ibid*., 277.

In the textbooks for Criminal Law most of the topics have no inherent gender dimension. Topics that inherently have a gender dimension are not considered in a gender-sensitive way.[71] An explanation of the gender dimensions of sexual violence is lacking. Insufficient attention is paid to criminal acts with elements of discrimination. The social danger of hate and honor crimes is not examined.

6. CONCLUSION

The results of the pilot analysis show almost a complete absence of gender-sensitive approaches in curricula and textbooks. In some of the analyzed textbooks we even encountered gender stereotypes**.** None of the textbooks provide gender-sensitive explanations of the historical genesis and development of modern and contemporary law. The language of study programs, of syllabi and textbooks is, as a rule, gender insensitive.

All of this indicates that legal studies do not meet the normative and strategic aims and standards proposed by Serbian education and government bodies regarding gender mainstreaming of higher education.

Our initial premises in this analysis – that higher education institutions and law schools should pursue gender equality policy and that they might factually contribute in a systemic way to its implementation through gender mainstreaming of study programs, syllabi and textbooks – have been shown by the state of affairs to be utterly lacking.

Recommendations have to be oriented towards enacting gender action plans for gender mainstreaming of all higher education institutions, including faculties of law. Gender action plans of this kind are quite necessary. They should contribute to the systemic improvement of the quality of study programs and textbooks, overcoming patriarchal cultural patterns in "hidden curricula", better balancing human resources within research and education processes, enabling the career promotion of women in science and academia, and also achieving gender-sensitive statistics.

Politics of gender mainstreaming of higher education and referential action plans could contain the following measures, among others:

Application guidelines for institution accreditation should include obligatory inclusion of gender-sensitive purposes, aims, learning outcomes for study programs and syllabi wherever reasonably appropriate. Moreover, an obligatory precondition for successful accreditation should be a proposed gender-sensitive approach in curricula and syllabi. In short,

[71] For example, there is no consideration in these textbooks of the legislative rule according to which "the serious and persistent resistance" of a rape victim represents an important element of the criminal act of rape. D. Jovašević, 87; Z. Stojanović, O. Perić, 101.

accreditation of study programs should be conditioned by a mandatory articulation of aims, outcomes, competences, syllabi contents and textbooks that are gender-sensitive.

Standards for a gender-sensitive approach concerning content and language of textbooks should also become obligatory. Textbooks should be subject to systemic checks from the viewpoint of gender-sensitive language, aversion to stereotypes and prejudices, as well as a gender-sensitive approach to inherently gendered phenomena. There should also be consideration of numerous other topics that have inherent but obscured gender dimensions, which can be revealed and articulated in a gender-sensitive manner. In addition to containing entries about contributions by female authors to a given field, textbooks should note the longstanding invisibility of women in modern universal legal norms and the history of feminist and other forms of emancipatory struggles for their visibility. In other words, legal textbooks should become a materialized awareness about the difference between a gender-neutral and gender-sensitive understanding of the history of law and genesis of legal institutes and norms. They also ought to delve deeper into gender-sensitive comprehension and implementation of the legal system. Even if the authors of textbooks have personal value affiliations close to gender stereotypes, they must leave aside stereotyped interpretations of legal phenomena and institutes. Normative and strategic documents regarding higher education in the Serbian state, as well as the highest civilization standards of international law, demands that all authors respect a gender-sensitive approach in articulating textbook contents.

It is necessary to transfer knowledge to students through lectures and textbooks about new gender-sensitive legislations. It is also necessary to amend university education by eliminating the patriarchal matrix of the "hidden curricula". It is also important to introduce training seminars for educators; to organize open days devoted to issues of gender equality; to publish gender-instructive booklets for students; to organize instructive seminars for all participants in the educational process, including the media and journalists.

It is essential to enrich particular courses with gender dimensions and gender-sensitive attitudes, systematically introduce gender study courses, as well as Masters and PhD programs on gender issues.

A further goal are offices for human resources and gender issues. Responsible for better gender balancing, they will ensure that application forms and procedures for recruiting new employees allow for the career promotion of female candidates in academia. These offices would introduce systemic measures for the counteracting the negative effects of pregnancy and parenthood on women's careers in academia, and for better balancing of work and care for parents, whether they are both employed at the university or not.

There should be obligatory introduction of gender-sensitive statistics and budgeting.

The next step in the development of legal education is integrating gender equality. Yet, there is a huge discrepancy between normative and declarative proposals and the reality of higher and legal education. This problem must be overcome, that is, gender equality must be brought into the foreground, above all, for the continued improvement of the quality of the legal education and the legal profession.

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TRANSFER PRICING IN SERBIA – FACING A SOBERING REALITY

This paper attempts to systematize the basic pillars of Serbian policy in the area of corporate income taxation of related party transactions (transfer pricing). The author looks at the very first Serbian transfer pricing legislation introduced in 1991 and follows its development through to the present. Principle focus is directed towards the policy drivers behind the 2012 and 2013 comprehensive reform of the Serbian transfer pricing provisions, which the author analyses with the added value of hindsight. Despite a generally positive view on what was achieved by the 2012 amendments to the Serbian transfer pricing legislation, the author offers a divergent view. A critical assessment is provided and the author stipulates the reasons which suggest that the respective amendments failed to meet desired goals in the area of transfer pricing set in 2012 and 2013. The author tries to deduce the lessons that should be taken into consideration in the future legislation reform initiatives and attempts to find alternative paths that should be taken in order to avoid repeating identical mistakes.

Key words: *Transfer pricing. − Amendments. − Safe harbor. − OECD.*

1. INTRODUCTION

Although transfer pricing may seem only a complex and rather technical area of tax law, in Serbia (and perhaps not only in Serbia) the story of the development of provisions dealing with the tax treatment of related party transactions (i.e. transfer pricing) may provide us with some sobering lessons that could easily be applied in various other fields of legislation. The primary focus of our further deliberations will be the deduction of what were the principles driving Serbian policy makers when tailoring transfer pricing legislation and the assessment of whether they

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were able to accomplish their desired goals. The story of transfer pricing in Serbia will bring us face to face with the rather worrying state of the Serbian policy and administrative infrastructure and the need to consider this factor when contemplating future normative development. It will also show the level of self-imposed isolation that the Serbian policy makers and government administration are content to dwell in. While we will attempt to determine the reasons for the failure of Serbian policy makers to bring Serbia, within the ambit of transfer pricing, in line with at least its neighbors, an attempt will also be made to propose alternatives to the approach that has been tried many times and is evidently unsuccessful.

2. THE BASIC PRINCIPLES OF SERBIAN TRANSFER PRICING LEGISLATION AND THE ORIGINS OF THE TRANSFER PRICING CONTROVERSY

Serbia introduced specific transfer pricing legislation as early as in 1991[1] and in its design it adopted the arm's length principle, which is stipulated in Art. 9(1) of the OECD Model Tax Convention on Income and on Capital:[2]

"Where

a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or

b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State,

and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly." Furthermore, Serbia relied on the initial work done under the auspices of the OECD in developing the methodology for the implementation of the arm's length principle.[3]

[1] See: Articles 53–56 of the Corporate Income Tax Law, *Official Gazette of the Republic of Serbia*, No. 76/91.

[2] The OECD's definition of the arm's length principle has remained unaltered since its introduction in the 1963 OECD Draft Double Taxation Convention on Income and on Capital.

[3] Report of the OECD Committee on Fiscal Affairs on Transfer Pricing and Multinational Enterprises (OECD 1979), International Organizations' Documentation IBFD;

However it was not until the end of the first decade of the 21st century that the topic of the treatment of related party transactions received much attention from the Serbian tax profession in general.[4] While the turmoil of the 1990s can be relied upon to explain the *dormancy* in the application of the Serbian transfer pricing norms at the time, during the beginning of the 21st century an excuse can be found in the view that the Serbian Ministry of Finance and the newly created Serbian Tax Administration (established in 2002) had more pressing issues to address.

To understand the potential relevance of transfer pricing rules we must revert to the principles of Serbian policy in the area of corporate income taxation. Namely, in an attempt to attract as much foreign investment as possible Serbian tax legislation provided one of the lowest corporate income tax rates in Europe.[5] The vast majority of the foreign investments that have entered the country were sourced from multinational enterprises, while complex domestic business structures also developed and expanded. Thus, as in other parts of the world, Serbia witnessed an ever increasing volume of related party transactions. Whole sectors of the Serbian economy quickly became an integral part of the globalized market and rely heavily on their foreign or domestic affiliates for their day-to-day operations (e.g. the financial sector, telecommunications, energy sector, automotive manufacturing, food processing, etc.).

As related party transactions are a crucial part of the Serbian economy, which is also heavily dependent on foreign investments, one cannot overemphasize the importance of their tax treatment. Two main potential adverse consequences may arise from the improper application of transfer pricing legislation. If transfer pricing rules are not applied and audited with diligence taxpayers may be tempted to shift profits between related parties in a way that would allow them to lower their overall tax obligations (tax obligations at the level of the group). Therefore, proper application of transfer pricing norms is important in order to protect government fiscal revenues. However, improper application in the form of an overly aggressive posture by the tax administration when applying transfer pricing provisions may lead to equally worrying consequences. Namely, if one of the key incentives for attracting foreign investment is a low corpo-

Transfer Pricing and Multinational Enterprises, Three Taxation Issues, OECD, Paris 1984.

[4] For an overview of the legislative development of Serbian transfer pricing provisions from 1991 until 2010 see: S. Kostić, "The New Serbian Transfer Pricing Rules", *Tax Notes International* 4(71)/2013, 345–347.

[5] From 2004 until 2012 the corporate income tax rate in Serbia was 10%, while as of 2013 it was increased to a still comparatively quite modest 15%. For example, in 2013 the average corporate income tax rate in the European Union stood at 24,5%. See: S. Ranđelović, "Osvrt 2. Analiza parametarske reforme poreza na dobit preduzeća u Srbiji", *Kvartalni monitor* 31/2013, 62.

rate income tax rate, applying tax legislation in a way that can easily make this incentive irrelevant[6] will quickly lead potential investors to either seek informal protection from the tax authorities (thus contributing to the already existing problem of government corruption) or to find alternative destinations for their capital. With respect to Serbia, the facts that the country is relatively small, does not possess significant natural recourses, and is surrounded by jurisdictions offering similar incentives and opportunities to investors, all further contribute to the need not to send wrong signals to the global market.

Although rumors regarding a potentially significant transfer pricing case were present a lot earlier, it was on 24 December 2010 that the Serbian tax community was publicly confronted with a new reality. A CFO of a company that is a part of a notable multinational group (Carlsberg) had criminal charges for tax evasion brought against him by the Serbian Tax Administration, wherein one of the reasons for such an action was the alleged underpayment of corporate income tax by virtue of applying presumably lower than market prices in related party transactions.[7]

The Carlsberg case had tremendous impact on the way in which the issue of transfer pricing was viewed in Serbia. It showed that the Serbian Tax Administration was prepared to confront a major foreign investor (or to be more precise its Serbian subsidiary) on the tax treatment of transactions that take place within a multinational enterprise. Furthermore, it testified to a highly aggressive posture of the Serbian Tax Administration, which not only brought criminal charges against the taxpayer's CFO, but also made its accusations public.[8] On the other hand, unofficial information regarding the case implied that the Serbian Tax Administration gave no credibility to the internationally accepted methodology of dealing with transfer pricing, based on the 1995 OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, well-established at the time, and even more importantly completely disregarded the documentation, provided by the taxpayer, which was widely accepted for identical purposes in numerous other tax jurisdictions.

What was even more worrying was the fact that at the time, apart from very scarce provisions of the Serbian Corporate Income Tax Law[9]

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[6] See: G. Ilić-Popov, S. Kostić, "Transferne cene u Srbiji", *Industrija* 4/2011, 178.

[7] Finansijski direktor "Carlsberg Srbija" osumnjičen za utaju, *http://www.blic.rs/vesti/hronika/finansijski-direktor-carlsberg-srbija-osumnjicen-za-utaju/fkq020n*, last visited 2 October 2017.

[8] While the public announcement of brining criminal charges against a taxpayer raises issues of both tax secrecy and intentional taxpayer defamation, the scope of this article does on allow us to discuss these important issues.

[9] Articles 59−61 of the Corporate Income Tax Law, *Official Gazette of the Republic of Serbia*, No. 25/01, 80/02, 80/02, 43/03, 84/04, 18/10.

and corresponding regulations,[10] no other sources dealing with the issue of transfer pricing were available in Serbian language. Taking into account the level of foreign language proficiency within the Serbian Tax Administration and the lack of information regarding any comprehensive training or preparation for the purposes of auditing related party transactions by its inspectors, the Serbian tax community was concerned with the actual capability of the Serbian Tax Administration to properly apply the respective legislation. Such concerns were further exacerbated by the fact that the foreign investors community in Serbia has, to no avail, since 2007 publicly warned on the poor quality of the Serbian transfer pricing legislation:

"Provisions governing transfer-pricing are too vague and are rarely implemented in practice. The lack of legislative guidance and any reliable practice in this area have caused significant uncertainties as to the way taxpayers should handle their related-party transactions."[11]

In essence, Serbian taxpayers were faced with a tax authority that was evidently ready to immediately levy a heavy hand in applying insufficiently clear legal provisions, in whose application it had virtually no prior experience or training, and where it had no Serbian language professional literature to rely on for further guidance.

The issuing of the new Rulebook on the Contents of the Tax Balance Sheet and Other Issues Relevant for the Determination of the Corporate Income Tax (hereinafter: the Rulebook) on 21 December 2010[12] only contributed to the aforementioned concerns, as its provisions relating to the definition of what is to be deemed an arm's length interest rate, for the purposes of testing related party loans,[13] showed that not only the Serbian Tax Administration, but the Ministry of Finance in general did not have a sound grasp of the basic principles of transfer pricing. The problem was of such magnitude that the Rulebook had to be amended in this respect already on 8 February 2011.[14] While the newly introduced amendments

[10] Article 5 of the Rulebook on the Tax Balance Sheet of Corporate Income Taxpayers, *Official Gazette of the Republic of Serbia*, No 139/04.

[11] *White Book – Proposals for improvement of the business environment in Serbia*, Foreign Investors Council, 2007, 37; *White Book – Proposals for improvement of the business environment in Serbia*, Foreign Investors Council, 2008, 53; *White Book – Proposals for improvement of the business environment in Serbia*, Foreign Investors Council, 2009, 72; *White Book – Proposals for improvement of the business environment in Serbia*, Foreign Investors Council, 2010, 95.

[12] The Rulebook on the Contents of the Tax Balance Sheet and Other Issues Relevant for the Determination of the Corporate Income Tax, *Official Gazette of the Republic of Serbia*, No. 99/10.

[13] Article 5(7) of the Rulebook.

[14] Article 2 of the Rulebook on the Contents of the Tax Balance Sheet and Other Issues Relevant for the Determination of the Corporate Income Tax, *Official Gazette of*

pacified the main vested interests that lobbied for them (primarily the financial sector, i.e. banks), even the improved provision warranted a harsh, but in our opinion fair, assessment from the foreign investor community:

"By-laws for determining arm's length interest rate on loans between related parties are not in accordance with the provisions of CIT Law and best international practice, and should be abolished."[15][16]

With all the problems with respect to transfer pricing becoming so evident within the space of a single year, the Serbian Government voted into office in the late spring of 2012 had its task set out.[17]

3. THE POLICY BEHIND THE 2012 AMENDMENTS TO THE SERBIAN TRANSFER PRICING LEGISLATION

The Working Group for Amending the Corporate Income Tax Law (hereinafter: Working Group), which was formed in the summer of 2012 by the Ministry of Finance, received a broad mandate, with the improvement of the Serbian transfer pricing normative framework being at the top of its agenda. In this paper we will not address the finer points of the changes introduced into this area of tax legislation in late 2012, but will focus more on the goals that the Working Group and the Serbian Government wanted to achieve.

The basic idea behind the 2012 Serbian transfer pricing amendments was to simultaneously:

1) defend Serbia's public revenues,
2) ensure durable legal certainty in the area of transfer pricing and send a strong message to the international business community that Serbia is a safe place to invest ("wash away the Carlsberg case sin"), and
3) assist the creation of the administrative capacity necessary for achieving the previous two goals.

Already in the autumn of 2011 the Serbian Fiscal Society, an association of tax professionals and the Serbian national branch of the International Fiscal Association, translated the 2010 OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (here-

the Republic of Serbia, No. 8/11.

[15] *White Book – Proposals for improvement of the business environment in Serbia, Foreign Investors Council*, 2011, 112.

[16] *Cf.* G. Ilić-Popov, S. Kostić, 160.

[17] 2012 Serbian parliamentary elections were held on 6 May.

inafter the OECD Transfer Pricing Guidelines) into Serbian language[18] and, in an attempt to assist them in capacity development, donated a considerable number of copies to the Serbian Tax Administration and the Ministry of Finance. In some countries it was the translation of the OECD Transfer Pricing Guidelines into the official language and the reliance on them by the tax authorities that drove the development of the domestic transfer pricing practice.[19] However, in Serbia it became evident that the Serbian Tax Administration would not take any independent action unless provided with an explicit legislative instruction to do so. Therefore, the Working Group took on the task of preparing detailed amendments that would allow for as much clarity as possible in an inherently vague area of tax law and bring Serbian tax legislation in line with the best current comparative practices. The actual depth of the 2012 amendments can be described with some ease by virtue of a simple word count comparison. Transfer pricing norms within the Corporate Income Tax Law increased from a total of 335 words (2088 characters with spaces) to 1116 words (7140 characters with spaces). While the legislative text almost quadrupled, the body of the transfer pricing regulations increased more than tenfold (from 347 words to 3553 words dedicated to transfer pricing).

With respect to the role of the OECD Transfer Pricing Guidelines, the Working Group decided to be cautious. Namely, despite strong voices advocating that they be made part of the Serbian tax legislation,[20] or to at least make them binding for the Serbian Tax Administration only,[21] it was decided not to give the OECD Transfer Pricing Guidelines official status under Serbian law, but to allow them to have some form of a soft-law role.[22] Such a policy decision was supported by the following arguments:

1) The OECD Transfer Pricing Guidelines are not meant to be a statutory document – they provide thoughts and dilemmas, alternative approaches to solving problems and sometimes will not take a firm position on an issue. In other words, they are

[18] *Smernice OECD za primenu pravila o transfernim cenama za multinacionalna preduzeća i poreske uprave*, Srpsko fiskalno društvo – OECD, Beograd 2011.

[19] E.g. Croatia. See: N. Tucaković, M. Vergles, "Nadzor transfernih cijena", *Porezni vijesnik* 7/2008.

[20] E.g. Slovakia from 1 January 1997 until 31 December 2000. See: B. Ďurajka, Z. Blažejová & M. Zima, Slovak Republic − Transfer Pricing, Topical Analysis IBFD, last visited 1 October 2017.

[21] E.g. in Austria in 2010, by virtue of the ministerial decree BMF-010221/2522-IV/4/2010. See: S. Bernegger, W. Rosar & T. Tanzer, Austria − Transfer Pricing, Topical Analysis IBFD, last visited 1 October 2017.

[22] A similar approach is applied in Hungary and to some extent in Poland. See: J. Jancsa-Pék, Hungary − Transfer Pricing, Topical Analysis IBFD, last visited 1 October 2017; M. Aleksandrowicz *et al*., Poland − Transfer Pricing, Topical Analysis IBFD, last visited 1 October 2017.

adequate as a source to be relied upon when preparing domestic transfer pricing provisions, but cannot to be introduced unaltered into legislation.

2) Serbia is not an OECD member and due care should be taken when adopting documents in whose drafting the country did not have a voice.

3) Other potential sources on transfer pricing were in the final phase of development at the time, primarily the United Nations Practical Manual on Transfer Pricing for Developing Countries (published in 2013).

Thus, the enabling provision of Art. 61a of the Corporate Income Tax Law was tailored to state: "The Minister of Finance shall, relying on sources dealing with the tax treatment of related party transactions from the Organization for Economic Cooperation and Development (OECD), as well as other international organizations, introduce more detailed regulations for the implementation of the provisions of Art. 10a and Arts. 59–61 of this Law."[23]

In addition to granting the soft-law status for the OECD Transfer Pricing Guidelines (as well as other international sources which may gain global recognition in the future), the highly unusual, for Serbian circumstances, explicit mentioning within a piece of legislation of non-binding sources for the Minster to rely on when drafting regulations had one more purpose. Namely, Serbia was evidently far behind other Central and Eastern European countries when it came to following global developments: e.g. the Slovakian Ministry of Finance was responsible for the translation of the 1995 OECD Transfer Pricing Guidelines back in 1997; the Croatian tax authority took upon itself the same task publishing the 1995 OECD Transfer Pricing Guidelines within a broader transfer pricing audit manual;[24] while the Bulgarian tax authorities have cooperated since 2008 with their French counterparts on developing transfer pricing legislation and capability.[25] In Serbia there have been no initiatives from the tax authorities for the development of expertise and capacity, but rather they were almost exclusively driven by the academic and private sectors. Although it may seem crude, the Working Group wanted to send a strong message to the Serbian tax authorities that they must follow most the relevant global developments with greater care and diligence – and actu-

[23] See: Article 42 of the Law on the Changes and Amendments to the Corporate Income Tax Law, *Official Gazette of the Republic of Serbia*, No. 119/12.

[24] *Priručnik o nadzoru transfernih cijena*, Porezni vijesnik – Institut za javne financije, Zagreb 2009.

[25] M. Yancheva, Bulgaria − Transfer Pricing, Topical Analysis IBFD, last visited 1 October 2017.

ally stipulating such a message in the legislation itself was thought to be sufficiently to the point.

Finally, in the area of transfer pricing Serbia introduced some of the most demanding compliance obligations in the world. Serbia requires that its taxpayers prepare quite detailed transfer pricing documentation i.e. documentation wherein they are to provide all information on their related party transactions and to demonstrate that these were undertaken in accordance with the arm's length principle. Such documentation is to be submitted annually to the tax authorities together with the Corporate Income Tax balance sheet. In the event of deviation from the arm's length standard, in dealings with related parties resulting in an understatement of the tax basis, taxpayers are obliged to self-adjust their tax obligations within the tax balance sheet for the respective year for which it is being submitted.[26]

Since in most other jurisdictions transfer pricing documentation is provided to the tax authorities on request and taxpayers are not subjected to such stringent reporting obligations, a logical question arises why was such an approach applied in Serbia. What may be even more puzzling is the realization that the described compliance obligations were not introduced at the insistence of the Serbian Tax Administration, which almost took no part in drafting of the 2012 transfer pricing amendments.

There were two main drivers behind the strict attitude on compliance obligations adopted by the Working Group:

1) The first one was the desire to "discipline" Serbian taxpayers ahead of the Serbian Tax Administration developing full capability to competently deal with transfer pricing. By doing so the goal of defending public revenues would be achieved as taxpayers were expected to do their utmost to avoid potential audits and conflicts with the Serbian Tax Administration.
2) The second one was to provide an exceptional opportunity for the education of the Serbian Tax Administration. Namely, the Working Group was well aware of the fact that at the time there were virtually no transfer pricing capabilities at the level of the Serbian Tax Administration.

Furthermore, the Serbian Tax Administration was suffering and was yet to suffer from austerity measures introduced by the Government as a part of a broader drive for fiscal consolidation. By subjecting Serbian taxpayers to such broad reporting obligations, the Working Group aimed to provide the Serbian Tax Administration with the finest transfer pricing

[26] See: Article 40 of the Law on the Changes and Amendments to the Corporate Income Tax Law, *Official Gazette of the Republic of Serbia*, No. 119/12.

library possible, a library that would allow it to quickly systematize and develop its own approach to numerous transfer pricing issues. The formalization of the transfer pricing documentation template further enabled the comparative analysis of individual taxpayers.

The Working Group expected that the Serbian Tax Administration would jump at such an exceptional opportunity to develop itself essentially at the expense of the taxpayers, as they were to pay the cost of educating the Serbian Tax Administration by being subjected stringent compliance obligations. Furthermore, it was believed that once adequate capabilities were developed, the Serbian Tax Administration would be in the position to ease the taxpayer's administrative burden and propose measures to that effect.

4. ASSESSMENT OF THE SUCCESS OF THE POLICY BEHIND THE 2012 AMENDMENTS TO THE SERBIAN TRANSFER PRICING LEGISLATION

One could easily be tempted to give a positive assessment of the success of the policy behind the 2012 amendments to the Serbian transfer pricing legislation. However, we will try to show why this temptation should be resisted and why a negative stance is far more appropriate.

The 2012 amendments to Serbian transfer pricing legislation have now been in force for almost five years and during this period they have not caused any notable controversy. One of the reasons for this may lie in the very open public debate process from which they had emerged. Despite the previously described burdensome compliance obligations, the business community, particularly foreign investors, seems to be content with the current transfer pricing environment, as opposed to the one in force prior to the 2012 amendments. If we go back to the White Book published annually by the Foreign Investors Council (FIC) in Serbia, we see that apart from a notable praise given to the new transfer pricing legislation in 2013,[27] transfer pricing is essentially taken off their agenda in the subsequent years.[28] Independent authors have also given a high rating to the 2012 transfer pricing amendments, with Kireta stating, in regard to the supporting regulations, that they have "positioned Serbia as the most

[27] See: *White Book – Proposals for improvement of the business environment in Serbia*, Foreign Investors Council, 2013, 109.

[28] See: *White Book – Proposals for improvement of the business environment in Serbia*, Foreign Investors Council, 2014, 116–118; *White Book – Proposals for improvement of the business environment in Serbia*, Foreign Investors Council, 2015, 132–134; *White Book – Proposals for improvement of the business environment in Serbia*, Foreign Investors Council, 2016, 158–162.

advanced country in the region in terms of transfer pricing regulations."[29] Cooper and Skopljak have been more critical, although generally positive,[30] with their primary criticism directed at a "potentially significant and disproportionate compliance burden" that Serbian transfer pricing documentation requirements may impose on taxpayers.[31]

It has also been widely recognized, although no official data on the matter exists at the moment, that the introduction of the 2012 transfer pricing amendments resulted in a significant increase in corporate income tax revenue collected by the Serbian *fiscus*, with no corresponding implementation costs incurred by the Serbian Tax Administration.

When one takes into account the previously stated, it would seem that at least two of the three policy goals behind the 2012 Serbian transfer pricing amendments have been achieved:

1) public revenues have not only been protected, but have increased due to the introduced measures,
2) the business community and particularly foreign investors have given a vote of confidence to the adopted provisions.

Unfortunately, we must point out several worrying phenomena, which will illustrate why it is advisable to be far more cautious when it comes to the actual reach of the 2012 Serbian transfer pricing amendments.

Firstly, the primary reason why the Serbian transfer pricing legislation introduced after 2012 has caused so little controversy is that in the past five years the Serbian Tax Administration has not attempted any comprehensive transfer pricing audits. In other words, the new Serbian transfer pricing legislation has not yet been tested in adversary proceedings between taxpayers and the Serbian Tax Administration.

Secondly, the Serbian Tax Administration has made virtually no effort to build up its capacities in the area of transfer pricing: no investments have been made in material infrastructure, and there have been no changes in the internal organization of the Serbian Tax Administration which would enable pooling of talent and recourses for the purposes of auditing related party transactions. The compliance burden imposed on the Serbian taxpayers with the intent of this sacrifice to serve a higher purpose has been in vain. To add insult to injury, the Serbian Administra-

[29] I. Kireta, "New Transfer Pricing Rules: Confirmation That the Tax System Is Aligning with International Tax Norms?", *21 Intl. Transfer Pricing J.* 4(2014), Journals IBFD, 302.

[30] See: J. L. Cooper, Z. Skopljak, "Transfer Pricing in the Western Balkans: The Current State of Play", *20 Intl. Transfer Pricing J.* 6(2013), Journals IBFD, 388 – 391.

[31] See: *Ibid.*, 391.

tive Court has failed to provide any guidance on the interpretation of fundamental transfer pricing principles, despite having at least one clear opportunity to do so since 2012.[32]

Thirdly, the legislating of the necessity to follow global developments in Art. 61a of the Corporate Income Tax was to no avail. Even such a drastic measure, rarely seen in the Serbian normative environment, achieved nothing. In the area of international taxation and transfer pricing developments in particular, Serbia, or to be more precise the awareness of the Serbian tax authorities of these developments, is at the absolute end of the line, not only seen from a European, but also from a global perspective.

The reasons for such a harsh assessment can be illustrated with some ease. Namely, less than one year after the introduction of the 2012 Serbian transfer pricing amendments, the heads of governments of the G20 nations, at their 2013 St. Petersburg summit, endorsed the Base Erosion and Profit Shifting (BEPS) Action Plan, prepared by the OECD, which encouraged all countries to join the process. Essentially "in 2013, OECD and G20 governments embarked on the most significant re-write of the international tax rules in a century"[33] with transfer pricing being at the core of the entire BEPS initiative. The uniqueness of the BEPS project cannot be overemphasized as it is remarkable not only from the perspective of the goals it aims to achieve and the breadth of the changes it wants to introduce, but also due to such unprecedented political relevance having been accorded to a tax issue. As the BEPS project has and will have a global impact, the G20 and the OECD opened the doors to all the countries of the world to participate in developing its action plans, through the Inclusive Framework, which has been joined by 102 jurisdictions (as of 6 July 2017).[34] A closer look at the list of jurisdictions participating in the Inclusive Framework on BEPS reveals that on the European continent

[32] See: III-3 U.28215/10 from 6 December 2013.

[33] OECD/G20 Base Erosion and Profit Shifting Project – 2015, Final Reports – Information Brief, 3, *https://www.oecd.org/ctp/beps-reports-2015-information-brief.pdf*, last visited 2 October 2017.

[34] Andorra, Angola, Argentina, Australia, Austria, Barbados, Belgium, Belize, Benin, Bermuda, Botswana, Brazil, British Virgin Islands, Brunei Darussalam, Bulgaria, Burkina Faso, Cameroon, Canada, Cayman Islands, Chile, China (People's Republic of), Colombia, Congo, Costa Rica, Côte d'Ivoire, Croatia, Curaçao, Czech Republic, Democratic Republic of the Congo, Denmark, Djibouti, Egypt, Estonia, Finland, France, Gabon, Georgia, Germany, Greece, Guernsey, Haiti, Hong Kong (China), Hungary, Iceland, India, Indonesia, Ireland, Isle of Man, Israel, Italy, Jamaica, Japan, Jersey, Kazakhstan, Kenya, Korea, Latvia, Liberia, Liechtenstein, Lithuania, Luxembourg, Macau (China), Malaysia, Malta, Mauritius, Mexico, Monaco, Montserrat, Netherlands, New Zealand, Nigeria, Norway, Pakistan, Panama, Papua New Guinea, Paraguay, Peru, Poland, Portugal, Romania, Russia, San Marino, Saudi Arabia, Senegal, Seychelles, Sierra Leone, Singapore, Slovak Republic, Slovenia, South Africa, Spain, Sri Lanka, Sweden, Switzerland, Thailand, Turks and Caicos Islands, Turkey, Ukraine, United Kingdom, United States, Uruguay and Viet

only the following countries are (self)isolated from this groundbreaking process: Albania, Belorussia, Bosnia and Herzegovina, Cyprus, Macedonia, Moldova, Montenegro, and sadly Serbia.

Finally, the capabilities of the Serbian Tax Administration to apply demanding legislative solutions are constantly deteriorating due to it being grossly understaffed and underfunded. It has far fewer options at its disposal today than it had in late 2012. Therefore, if the 2012 transfer pricing amendments were too demanding for the Serbian Tax Administration to implement at the time they were introduced, today they represent an essentially insurmountable obstacle.[35]

The presented evidence shows that the drafters of the 2012 Serbian transfer pricing amendments failed to grasp the fundamental deterioration of the Serbian administrative infrastructure, which is not capable of applying sophisticated and complex solutions. It is our proposition that the current state of affairs is but a lull, caused by the shift in the focus of the Serbian Tax Administration away from transfer pricing, which may be explained both by the desire not to adversely impact foreign investment and avoid all the unwarranted embarrassment that came out the Carlsberg case. In principle the essential goal of durable legal certainty in the area of the taxation of related party transactions has not been achieved. Not only has no transfer pricing capacity been developed by the Serbian Tax Administration, on the contrary, its capabilities today are notably weaker than they were five years ago. Finally, the initial increase in corporate income tax revenue will most likely evaporate once taxpayers fully digest the message sent to them by virtue of the Serbian Tax Administration's inaction. As was the case with the transfer pricing provisions of the Serbian tax legislation during the 1990s and the first decade of the 21st century, the ones introduced in and after 2012 are also in danger of being effectively forgotten and neglected, with only some formal recognition of their existence. However, as the Carlsberg case showed, the fact that a piece of legislation has been forgotten does not affect its legal status and its dormancy can be interrupted by a crude awakening.

5. CONCLUDING POLICY RECOMMENDATIONS

The restrictions imposed on Serbian tax policy makers, by virtue of a weak Serbian Tax Administration, have been noted numerous times by

Nam, *http://www.oecd.org/tax/beps/inclusive-framework-on-beps-composition.pdf*, last visited 1 October 2017 .

[35] For more on the state of the Serbian Tax Administration see: S. Kostić, "Administrativni okvir kao ključna prepreka usklađivanju srpskog poreskog prava sa pravom Evropske Unije", *Usklađivanje poslovnog prava Srbije sa pravom Evropske Unije* (ur. V. Radović), Pravni fakultet Univerziteta u Beogradu, Beograd 2016, 400–415.

independent observers, within whom the Fiscal Council of Serbia stands out as most vociferous in its calls for strengthening this crucial state authority.[36] Unfortunately, we have no indications that the Serbian Government has an understanding of the gravity of the situation and all the potential implications, not only further deterioration, but also maintaining the status quo may have on Serbian economic development and growth. In all fairness, the same can be said of past Serbian Governments as well. One can but lament for the "good old days" when such praise for the Serbian Tax Administration could be voiced by the foreign investors community:

"There are a number of examples of tax inspectors adopting a responsible and more educated approach when conducting audits of taxpayers."[37]

The reform of the Serbian Tax Administration will be a long and exhausting process, which will require much treasure and patience. Serbian tax policy makers and those in charge of drafting tax legislation must take into account the crucial element of the capability of the administrative infrastructure that will be in charge of implementing respective provisions. Otherwise we will be introducing norms which either will not be applied at all (or to be more precise, whose application will not be audited) or will be implemented improperly. In either eventuality, we are faced with increasing legal uncertainty and further loss of confidence in the public authorities, both of which adversely impact the business environment and economic growth. What we must not do is attempt to uncritically introduce comparative solutions into the Serbian legal environment, particularly those that stem from jurisdictions with a highly developed tax authority and a tax proficient judiciary.[38] Finally, what we should do is come to grips with the notion that Serbia is a developing country

[36] See: Fiskalna kretanja u 2016. godini, konsolidacija i reforme 2016−2020, Fiscal Council of Serbia, 20 June 2016, 59−60, *http://www.fiskalnisavet.rs/doc/ocene-i-misljenja/2016/Fiskalna_kretanja_2016_fiskalna_konsolidacija_2016–2020.pdf*, last visited 2 October 2017); Ocena predloga Zakona o budžetu za 2017. godinu i fiskalne strategije za period 2017−2019, Fiscal Council of Serbia, 9 December 2016, 8−9, *http://www.fiskalnisavet.rs/doc/ocene-i-misljenja/2016/Ocene%20budzeta%20za%202017%20i%20Fiskalne%20strategije%20za%20period%202017–2019.pdf,* last visited 2 October 2017; Fiskalna kretanja u 2017. godini i preporuke za 2018. godinu, Fiscal Council of Serbia, 29 September 2017, 9, *http://www.fiskalnisavet.rs/doc/ocene-i-misljenja/2017/Fiskalna%20kretanja%20u%202017.%20godini%20i%20preporuke%20za%202018.%20godinu.pdf,* last visited 2 October 2017.

[37] *White Book – Proposals for improvement of the business environment in Serbia*, Foreign Investors Council, 2005, 36; *White Book – Proposals for improvement of the business environment in Serbia*, Foreign Investors Council, 2006, 38.

[38] *Cf.* R. J.Vann, G. S.Cooper, "Transfer Pricing Money – the Chevron Case", *ITP @ 20 [1996 – 2016]: Celebrating Twenty Years of the International Tax Program of the New York University School of Law* (eds. H. D. Rosenbloom *et al*.), NYU School of Law, 2016, 445.

and begin to focus our attention on the experiences of countries that face same challenges and have similar problems.

On a concluding note, at least in the area of transfer pricing, Serbia should focus more on introducing broad safe harbor rules, because these provide predictability (i.e. legal certainty) and would allow the Serbian Tax Administration to concentrate what resources it has at its disposal on the worst cases of non-arm's length transfer pricing.[39] In the area of financial transactions between related parties we have years of positive experience with the functioning of existing Serbian safe harbor rules in the form of thin capitalization[40] and the publication by the Minister of Finance of the interest rate to be deemed at arm's length for transfer pricing purposes.[41]And here we may provide the final defense of the much criticized transfer pricing compliance obligations, introduced by virtue of the 2012 amendments. Namely, it is due to the fact that the Serbian Tax Administration is in possession of a detailed five year archive on virtually all related party transactions which took place in Serbia, that the preparation of sector specific fixed margins safe harbor rules[42] could be done far quicker and with greater precision in Serbia than in most other jurisdictions in the world. To end on a more positive note, perhaps the work done in 2012 has not been completely in vain

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[39] See: *United Nations Practical Manual on Transfer Pricing for Developing Countries*, United Nations, New York 2013, 74–76.

[40] Article 62 of the Corporate Income Tax Law, *Official Gazette of the Republic of Serbia* No. 25/2001, 80/2002, 80/2002 – dr. zakon, 43/2003, 84/2004, 18/2010, 101/2011, 119/2012, 47/2013, 108/2013, 68/2014, 142/2014, 91/2015, 112/2015.

[41] Article 61(3) of the Corporate Income Tax Law.

[42] An approach which would follow that which has been applied in Brazil for two decades. See: United Nations Practical Manual on Transfer Pricing for Developing Countries, 358−374.

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SILALA BASIN DISPUTE – IMPLICATIONS FOR THE INTERPRETATION OF THE CONCEPT OF INTERNATIONAL WATERCOURSE

This article deals with the concept of the international watercourse and legal rules that regulate management of shared water resources. It is prompted by the current dispute before the International Court of Justice (ICJ) which raises the question of what is exactly the purpose of these rules and what should be the object of their protection. The interpretation of customary international law in this field points to the conclusion that even an artificially created international watercourse does not preclude the application of international law.

Key words: *Shared water resources. – International watercourses. – ICJ.*

1. INTRODUCTION

The current dispute before the International Court of Justice (ICJ), pertaining the status and the use of waters of the Silala River, may be considered a test for this judicial institution; a test which will prove whether it is capable of legal interpretation that is creative in a way that, without going beyond the limits of the legal norm, takes into consideration the essence of the object of protection of that same norm. The opposing submissions by the parties to the dispute, Bolivia and Chile, present the ICJ with the choice between the conservative application of customary international law in the field of common water resources management and the progressive interpretation, which is incomparably more in touch with the purpose of these rules – to protect these resources and enable their use to the benefit of all potential users.

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To briefly introduce the reader to the subject matter of the dispute, let us begin by noting that the interpretations of the facts by the opposing parties present two, on the surface at least, irreconcilable positions. The Silala (also referred to as Siloli)[1] River system is a watercourse whose surface waters originate in Bolivian territory. Within a few kilometers, it flows overland and across the border into Chilean territory. The surface flows of the Silala River emanate from groundwater springs, which are fed by an aquifer that itself straddles the border between Bolivia and Chile.[2] So far both parties agree on the facts. Now, for the crux of the case, Chile contends that, still within Bolivian territory, these waters flow into a common watercourse, the Silala River, which runs in a south-westerly direction towards Chile due to the natural inclination of the terrain, therefore making the Silala River system an international watercourse, which in turn entitles Chile to use of the river's waters, in accordance with customary international law. Bolivia, on the contrary, contends that the Silala River Basin is not a transboundary watercourse, since the river has been artificially diverted to Chile, which means that Bolivia is entitled to the use of 100% of its water.

How can it happen that two such opposite statement of facts concern an object of nature, such as the watercourse? The answer to this question lies in the legal definition of the watercourse, which falls under the scope of the international legal regime of customary law of international water resources, as reflected by the provisions of the UN Convention on the Law of Non-Navigational Uses of International Watercourses (hereinafter: Watercourse Convention).[3] Article 2 of the Watercourse Convention states that for the purposes of the Convention *"*'Watercourse' means a system of surface waters and groundwaters constituting by virtue of their physical relationship a unitary whole and normally flowing into a common terminus." In the next paragraph of Article 2 is added that "'International watercourse' means a watercourse, parts of which are situated in different States." This has been interpreted by the International Law Commission (ILC) to include rivers and their tributaries, lakes, aquifers, glaciers, reservoirs and canals that receive water from or contribute water to portions of the watercourse situated in other states.[4] There is no doubt that this definition reflects a norm of general customary nature in interna-

[1] Bolivia refers to the water as the Silala; Chile refers to the water as the Siloli, see B. M. Mulligan, G. E. Eckstein, "The Silala/Siloli Watershed: Dispute over the Most Vulnerable Basin in South America", *Water Resources Development* 27/2011, 595.

[2] Dispute over the Status and Use of the Waters of the Silala, *Chile v. Bolivia,* ICJ, Application instituting proceedings, 6 June 2016, 1.

[3] Convention on the Law of the Non-Navigational Uses of International Watercourses (adopted 21 May 1997, entered into force 17 August 2014), UNGA Res 51/229 (21 May 1997), UN Doc A/RES/51/229.

[4] ILC, "Draft articles on the law of the non-navigational uses of international Watercourses (1997)", *Yearbook of the International Law Commission* 2/1994, 2.

tional law,[5] which is of interest to this dispute, since neither Chile nor Bolivia are signatories to the Watercourse Convention. However, as we can see from the wording of the definition, nowhere is it specified that a particular international watercourse must be created solely through natural means. In other words, it is never mentioned that human interference with its flow and origination may leave a particular watercourse outside of the scope of the definition. Neither is it stated that the human interference that changes the nature of a watercourse from a strictly national-bounded to the international one does not qualify it to fall under the scope of this definition. Therefore, the definition for the purpose of this case (and potential future ones) needs some dose of clarification and concretization and thus the ICJ's opportunity to creatively and purposefully execute this task. In this article I will argue why the choice of interpretation of the Silala Basin as an international watercourse would be the only choice in accord with the law. I will first offer an overview of the state of facts and law relevant to the crux of the dispute (part 2). Then, I will offer three different paths which the ICJ can take in interpreting the law to these facts to reach a suggested solution (part 3). Finally, I will argue that this line of reasoning will enhance the process of judicial settlement of water disputes, which has recently gained prominence in international relations, and which will in turn contribute to the protection of shared natural resources and the function of the ICJ itself (part 4).

2. STATE OF FACTS AND LAW CONCERNING THE SILALA DISPUTE

It is quite obvious why the dispute over water resources has occurred in the region with the intensive arid circumstances of the Atacama Desert, between two states that share a history wrought with misunderstandings.[6]

In the War of the Pacific, which was fought between Bolivia and Chile from 1879 to 1883, Bolivia lost access to the Pacific Ocean. The most important territorial loss was its coastal region, rich with mineral

[5] For the purposes of this statement see the analysis by this author in the article M. Vučić, "Pojam međunarodnog vodotoka i problemi njegovog pravnog definisanja", *Pravni život* 9/2016, 457−470. See also more generally about customary nature of these norms J. W. Dellapenna, "The Customary International Law of Transboundary Fresh Waters!", *International Journal of Global Environmental Issues* 1/2001, 264.

[6] Perhaps the most important of these is the War of the Pacific, in which Chile cut Bolivia's access to the Pacific Ocean. Already in the 1970s Glassner noted that Bolivian policy is to link a local watershed issued with wider geopolitical concerns, thus to "become essentially a tool with which the Bolivian government could unite its people on the less dramatic, but much more basic, question of an outlet to the sea", M. I. Glassner, "The Rio Lauca: Dispute over an International River", *Geographical Review* 60/1970, 192–207.

deposits. Part of Silala Basin was also included in this package of territorial losses. As any other conflict in the world, the War of the Pacific was fought primarily for control over the nitrate-bearing mineral, therefore another name – the Saltpeter War. After the war, Chile started to exploit its spoils of war through the excavations of rich saltpeter, gold, silver, and, chiefly, copper mineral deposits. Rail was the only reliable way to carry the minerals to market and steam engines required a constant supply of water, a scarce commodity in the Atacama Desert.[7]

The then English (now Chilean) investment group, FCAB,[8] identified the Silala springs as a potential source of water and requested from the Bolivian local administrative unit of the Prefecture of Potosí permission to use the springs to power their locomotives. In its letter of request, FCAB offered to leave a third of the volume of the Silala for "public use" but Bolivia never exploited the waters, except for possibly the occasional local llama herder and, more recently, the soldiers stationed at the nearby military base.[9] In 1908 the Prefecture of Potosí granted the company free concession to construct canals in Bolivian territory and use the waters of the Silala. This concession was revoked in 1997 by the Bolivian government. The explanation was that the waters had long been used for purposes other than those granted in the concession. Since annulling the 1908 concession, Bolivia has taken a number of potentially provocative actions with respect to the Silala.[10]

On the other hand, despite the absence of official diplomatic relations, the two countries have demonstrated efforts to cooperate on the issue. This cooperation produced a working group which, through several meetings, produced a draft preliminary bilateral agreement on the use of the waters of the Silala.[11] The agreement establishes that Bolivia would be compensated by Chilean users of the waters of the Silala and that "Bolivia is entitled, initially, to fifty percent of the total volume of water of which flows across the border... and that this percentage may be increased in Bolivia's favour, based on the results of joint studies, to be carried out under the agreement".[12]

However, Bolivia rejected the draft bilateral agreement, despite the economically impoverished indigenous community of Quetena Chico and

[7] B. M. Mulligan, G. E. Eckstein, 598.

[8] Ferrocarril de Antofagasta a Bolivia.

[9] B. M. Mulligan, G. E. Eckstein, 598.

[10] *Ibid*.

[11] "The Initial Agreement on Silala, or Siloli", made on 28 July 2009, provided to the media by the Chancellery of the Republic of Bolivia, *https://www.internationalwaterlaw.org/documents/regionaldocs/Silala/SilalaAgreement_English.pdf*, last visited 20 September 2017.

[12] *Ibid*.

the Bolivian Chancellery pushing for its signing. Its government declared Bolivia's sovereign right to the whole flow of the Silala, with an additional request for Chile to pay more than a billion dollars indemnity to Bolivia for unauthorized use of the waters. It was further requested that any negotiation with Chile should guarantee Bolivia access to the Pacific Ocean. As Mulligan and Eckstein note, this latter demand suggests that the issues surrounding the Silala are not entirely water-focused, and that other political and historical interests may be at play.[13]

Thus the dispute has made it to the ICJ. Although this is neither the first dispute involving the two countries before the ICJ,[14] nor the first dispute between Latin American states involving water resources,[15] its innovative feature lies in the prominent role to be played by the law on the use of transboundary water resources for non-navigational purposes. The international law applicable to transboundary water resources is based primarily on three substantive principles and a set of procedural mechanisms for the realization of these principles,[16] all of which are recognized under customary international law and have been codified in the Watercourse Convention.

The first of the substantive principles – equitable and reasonable utilization – is based on the right of every riparian state to an equitable share of the benefits of a transboundary watercourse (meaning river, lake, or aquifer). The correlative obligation of this right is to use the water body equitably and reasonably. Equity and reasonableness are gauged against a variety of factors, which include local hydrological and natural characteristics, social and economic criteria, negative impacts, and the availability of alternatives.[17]

The second principle, called the no-harm principle, is based on the idea that no state can use its territory in a way that can cause harm which is greater than some ordinary nuisance to the territory of another state. Therefore, a riparian state's sovereign right to use transboundary waters within its territory is limited to the extent that it causes significant harm to another riparian state. The obligation of the riparian is of a due dili-

[13] B. M. Mulligan, G. E. Eckstein, 600.

[14] See Obligation to Negotiate Access to the Pacific Ocean *(Bolivia v. Chile).*

[15] Fairy recently the ICJ dealt with water resources issues in three decisions – Construction of a Road in Costa Rica along the San Juan River (*Nicaragua v. Costa Rica*); Pulp Mills on the River Uruguay (*Argentina v Uruguay*); Dispute regarding Navigational and Related Rights (*Costa Rica v. Nicaragua*).

[16] See more on this in: M. Vučić, "Pravičnost i korišćenje zajedničkih vodnih dobara", *Zbornik radova Pravnog fakulteta u Nišu* 75/2017, accepted for publication.

[17] Watercourse Convention, articles 5−6. See also P. Cullet, "Water Law – Evolving Regulatory Framework", *Water Governance in Motion, Towards Socially and Environmentally Sustainable Water Laws* (eds. P Cullet, A. Gowlland-Gualtieri, R. Madhav, U. Ramanathan), Foundation Books, 2010, 27−31.

gence nature – it should try to avoid utilization of shared water resources that flow within its territory that can cause significant damage to other riparian states. This is related not only to the activities of the riparian itself but also to the activities of private actors, which must be prevented from polluting, reducing or diverting the flow of a watercourse or a lake in a way amounting to illegal utilization of shared waters.[18]

The first two principles could be called the "classical law on non-navigational uses of international watercourses". This author is of the opinion that principle of sustainable development, as a kind of an "umbrella" principle is the third material principle on which this legal branch is contemporarily founded. It actually encompasses a variety of material legal principles that have become part of customary international law in the field of environmental protection such as: the polluter pays principle, the environmental impact assessment principle, the obligation not to cause significant harm to the watercourse's environment. It consists also of some procedural duties such as: the duty to cooperate over transboundary waters, to regularly exchange data and information, to provide prior notification of and consult on planned activities related to transboundary waters.[19]

The question whether international water law principles can be applied to the dispute concerning the Silala Basin revolves around its categorization and description. Public international law in the domain of international water resources does not extend to artificial rivers, e.g. canals or other man-made systems. Although there is nothing in the norms of this law to suggest this is the only possible interpretation, international water law has so far been regarded to apply only where a transboundary water resource is determined to be naturally occurring. This is because artificial water resources are proprietary and subject to the agreements that created them. In the case of the Silala Basin, most of the spring flow is captured by artificial channels, constructed by FCAB under its 1908 concession from the Prefecture of Potosi, Bolivia, and which cross into Chile via a principal canal. This would suggest that the water in the canal is subject to the terms of the concession agreement rather than to international water law. However, geological, topographical, and historical evidence indicates that prior to canalization, the Silala springs likely flowed across the Bolivian–Chilean border following approximately the same path as the principal canal, since that canal follows the natural drainage

[18] Watercourse Convention, Article 7. See more in S.C. McCaffrey, *The Law of International Watercourses: Non-Navigational Uses*, Oxford University Press, Oxford 2007, 78.

[19] See the article M. Vučić, Application of the Principle of Sustainable Development to the International Law on Fresh Water Resources", *Social Change in the Global World*, Center for Legal and Political Research, Goce Delčev University, Štip 2016, 79–96.

features of the Silala Basin. The dilemma would then be whether international water law applies to a captured and canalized transboundary river?

Nevertheless, we would like to put an argument for the application of international water law principles even if it is not determined that, prior to the construction of the principal canal, the Silala flowed perennially and naturally across the border in the same location as that canal. The technical evidence that would probably be produced during the discussion in the ICJ will clear the matter in the future and certainly give a stronger support to the arguments presented here. However, in the meantime, the only way for the international water law to become relevant for the dispute is to regard the Silala watercourse as international by nature – meaning transboundary. And here emerges the potential for creative interpretation by the ICJ, which can be structured in several arguments, which will be analyzed in the following part of the article.

3. WINDOWS OF OPPORTUNITY FOR CREATIVE INTERPRETATION

At the start of this part of the discussion I would like to counterclaim one potential critique. One may ask whether the ICJ should at all use creative interpretation for the definition of legal terms – in this case, of the watercourse, in order to reach the conclusion that the Silala watercourse is international by nature. This critique might argue that it is not the task of the ICJ (or any other international court or arbitration) to create legal rules since it is not a subject of international law – it does not have the power to do so. The only possible interpretation would have to remain within the limits of the norm that regulates this issue, and that is the definition of the watercourse, from Article 2 of the Watercourse Convention. But the problem is that Article 2 is silent on this matter and so far no one has really bothered with this question – it has simply not come to the forefront of legal thought, which does not mean that it is unimportant, as we see how a very complex and potentially dangerous international dispute has arisen based on it. To answer this critique, I state that already included in the provisions of the Watercourse Convention which reflect customary law are points of reference for interpretation which are creative only in the measure of systematic interpretation, and not in the meaning of *contra legem* interpretation. The answers are all there, in the letters of other articles which must be interpreted systematically, with Article 2, and in the entire spirit of international water law.

3.1. Connection with transboundary aquifers

Let us start from the definition of the watercourse itself: "'Watercourse' means a system of surface waters and groundwaters constituting by virtue of their physical relationship a unitary whole and normally flowing into a common terminus." Now, this definition by itself offers a first window of opportunity for the ICJ. Opportunity is found in this connection between surface waters and groundwaters. Namely, the waters of the Silala begin as high altitude (over 4,500 m above sea level) wetlands (called *bofedales*) formed by groundwater springs that discharge in Bolivia, near the Bolivian–Chilean border. More than 70 small-volume groundwater springs have been identified in Bolivian territory.[20] The Silala Aquifer is considered a transboundary aquifer, but little is known about the underground flow component. If the aquifer indeed lies in both jurisdictions, the nascent body of international groundwater law may be relevant to the Silala dispute and the allocation and management of the aquifer. Moreover, the aquifer's surface expression (e.g. natural springs) and hydraulic relationship to the Silala watershed may also be implicated in the same governance scheme. What is imparted here is that natural transboundary character of the aquifer, in combination with its natural relation to surface waters of the same system, notwithstanding the artificial transboundary character of this surface part of the system, would still make the whole watercourse system transboundary by nature. This is especially true if the evidence is provided that, prior to the construction of the principal canal, the Silala River flowed perennially and naturally across the border in the same location as that canal.

This argument faces three challenges. Firstly, not all underground water is automatically groundwater, because variances in soil porosity and permeability create obscure clear-cut classifications.[21]

Secondly, it is not clear whether the same rules of customary nature apply to aquifers as to surface waters. International law has only recently turned its attention to the quite disordered legal status of transboundary groundwater,[22] but notable examples have generated formal and consultative arrangements, including the Genevese Aquifer along the French-Swiss border, the Hueco Bolson Aquifer between Mexico and the United States, the Abbotsford-Sumas Aquifer System in West Africa, and the Guarani Aquifer in South America.[23] In 1966, the International Law As-

[20] B. M. Mulligan, G. E. Eckstein, 595−596.

[21] J. W. Dellapenna, "A Primer on Groundwater Law", *Idaho Law Review* 49/2013, 265.

[22] G. E. Eckstein, "Managing Buried Treasure across Frontiers: The International Law of Transboundary Aquifers", *Water International* 36/2001, 573.

[23] C. R. Rossi, "The Transboundary Dispute Over the Waters of the Silala/Siloli", Lecture from the XVI World Water Congress of the International Water Resources Asso-

sociation (ILA) undertook a study of the customary international law on transboundary water resources,[24] and ultimately it produced the Helsinki Rules on the Uses of the Waters of International Rivers.[25] The ILA's Helsinki Rules treated international drainage basins as indivisible hydrologic units, incorporating "the phrase 'equitable utilization' to express the rule of restricted sovereignty as applied to fresh waters."[26] These characterizations reduced distinctions between legal regimes of groundwater and surface water, suggesting that the standard of equitable utilization should apply to surface and subsurface sources straddling international borders.[27] The application of the same legal standard made sense because such ground and surface waters represented the same body of water "moving in differing stages of the hydrologic cycle, and what is today one will tomorrow be the other."[28] Finally, the principle was incorporated into the

ciation, Cancun, Mexico, 2017, *http://wwc2017.iwra.org/congress/resource/ABSID284_ABSID284_Cancun_water_paper.pdf*, last visited 20 September 2017.

[24] Earlier 20th century attempts to codify this law included the Institute of International Law's Madrid Resolution on International Regulations Regarding the Use of International Watercourses for Purposes Other than Navigation (1911) and its Salzburg Resolution on Utilization of Non-Maritime International Waters (Except for Navigation) (1961), but the Helsinki Rules were the most substantively ambitious and covered uses other than those related to navigation. See S.C. McCaffrey, "The Codification of Universal Norms: A Means to Promote Cooperation and Equity?", *International Law and Freshwater: The Multiple Challenges* (eds. L. Boisson *et al*.), Edward Elgar 2013, 125−127.

[25] ILA, "The Helsinki Rules on the Uses of the Waters of International Rivers", (Helsinki Rules) 1966, *http://www.internationalwaterlaw.org/documents/intldocs/Helsinki_Rules_with_comments.pdf*, last visited 20 September 2017.

[26] J. W. Dellapena (2001), 273.

[27] *Ibid.*, 274.

[28] *Ibid*. See also The Helsinki Rules, articles 10 and 13, (commenting on the community of interests standard attaching to equitable utilization of international drainage basins and equal rights relating to navigable rivers). See also a number of cooperative agreements influenced by the Watercourse Convention, including the Agreement on the Cooperation for the Sustainable Development of the Mekong River Basin, 5 April, 1995, *http://www.mrcmekong.org/assets/Publications/policies/agreement-Apr95.pdf,* last visited 20 September 2017; Treaty Between His Majesty's Government of Nepal and the Government of India Concerning the Integrated Development of the Mahakali Barrage Including Sarada Barrage, Tanakpur Barrage and Pancheshwar Project, 12 February 1996, *http://www.internationalwaterlaw.org/documents/regionaldocs/Mahakali_Treaty-1996.pdf,* last visited 20 September 2017. Treaty between the Government of the Republic of India and the Government of the People's Republic of Bangladesh on Sharing of the Ganga/Ganges Waters at Farakka, 12 December, 1996, *http://www.ssvk.org/koshi/reports/treaty_on_farakka_india_bangladesh_4_ganga_river_water.pdf*, last visited 20 September 2017; 1994 Agreement between the Government of the People's Republic of China and the Government of Mongolia on the Protection and Utilization of Transboundary Waters, 29 April 1994, *http://faolex.fao.org/cgibin/faolex.exe?rec_id=012938&database=FAOLEX&search_type=link&table=result&lang=eng&form at_name=@ERALL*, last visited 20 September 2017; Agreement between Syria and Lebanon for the sharing of the Great Southern River basin waters and the building of a joint dam on it, 20 April, 2002, *http://faolex.fao.*

International Law Commission's (ILC) draft articles on transboundary aquifers.[29]

The third obstacle is again related to the poor relations between Chile and Bolivia, which impede scientific inquiry into the hydrological relationship between the underground and surface systems of this basin. It is not enough that developing legal considerations regarding ownership of aquifers are already wrought with environmental, economic, human rights, conflict and governance layers of complexity,[30] but both countries have forestalled efforts to provide scientific opportunity to investigate patterns of alluvial erosion, incidental runoff, intermittent flow and hydrologic connection – all important factors for any reliable analysis.[31] This is without going into what would arise if the facts were to prove that the hydrological basin commingles groundwater and surface water regimes shared by the disputants, which would prompt considerations of a condominium relationship. In private law, such an outcome would test the limits of public policy as a forced cohabitation. In international transboundary water law, which is a part of public international law, the ICJ would be then prompted to impart a new meaning of the evolving notion of community of interest.

3.2. The concept of community of interest

The movement towards a more unified understanding of groundwater and surface water first developed from transboundary surface water concerns. The hallmark case setting this movement into motion was the River Oder Case (1929).[32] Here, the Permanent Court of International Justice (PCIJ) introduced a "new approach" to navigable international watercourses by acknowledging the legal partnership that such watercourses formed between riparians. That partnership required cooperation and the application of an equitable principle, the community of

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org/cgibin/faolex.exe?rec_id=027944&database=faolex&search_type=link&table=result &lang=eng&format_n ame=@ERALL, last visited 20 September 2017.

[29] ILC, Draft Articles on the Law of Transboundary Aquifers, Article 4 (2008), *http://legal.un.org/ilc/texts/instruments/english/draft_articles/8_5_2008.pdf*, last visited 20 September 2017. For a history of the ILC's involvement with transboundary aquifers, see generally C. Yamada, "Codification of the Law of Transboundary Aquifers (Groundwaters) by the United Nations", *Water International* 36/2011, 557–565.

[30] I. Zodrow, "International Aspects of Water Law Reforms", *Water Law for the Twenty-First Century: National and International Aspects of Water Law Reform in India* (eds. P. Cullet *et al.*), Routledge, 2010, 36.

[31] C. R. Rossi, 5.

[32] Territorial Jurisdiction of the International Commission of the River Oder (*UK v. Poland*), Judgment, 1929 P.C.I.J. (ser. A) No. 23, at 5 (Sept. 10) (hereinafter *River Oder Case*).

interest standard.[33] This standard optimized economic uses of an entire river basin while limiting a state's sovereignty by imposing reciprocal limitations on the sovereignty of other states sharing the same basin. The PCIJ concluded this community of interest "becomes the basis of a common legal right, the essential feature of which are the perfect equality of all riparian States in the use of the whole course of the river and the exclusion of any preferential privilege of any one riparian State in relation to the others."[34]

By 1933, the Montevideo Declaration reflected this standard of equality by establishing the principle of prior notice to other interested states regarding plans to harness or alter the use of an international river "which may prove injurious."[35] The PCIJ extended this idea of reciprocal responsibility to circumstances involving alteration of the flow of international watercourses in the famous case involving the Diversion of Water from the River Meuse (1937).[36] A treaty signed in 1863 between two riparians permanently regulated the Meuse River's flow through Belgium and its debouching in the Netherlands, but both countries subsequently and unilaterally modified the treaty's terms by constructing canals that altered the river's flow. The Netherlands sought injunctive relief from Belgium's actions, but the Court sidestepped its claim (and Belgium's counterclaim that the Netherlands's prior actions forced Belgium's hand), and held that neither party had violated the objects and purposes of the 1863 treaty.[37] Instead, it applied the principle of equality, which resulted in a future and negotiated settlement between the parties. In his famous individual opinion, Judge Manley O. Hudson addressed more forthrightly what the equitable understanding of equality implies: "[W]here two parties have assumed an identical or a reciprocal obligation, one party which is engaged in a continuing nonperformance of that obligation should not be permitted to take advantage of a similar non-performance of that obligation by the other party."[38] Hudson's individual opinion essentially recalled the Roman law maxim *inadimplenti non est adimplendum* (he who

[33] L. del Castillo-Laborde, "Case Law on International Watercourses", *The Evolution of the Law and Politics of Water* (eds. J.W. Dellapenna, J. Gupta), Springer, 2008, 319–320.

[34] *River Oder Case*, 27.

[35] Declaration of the Seventh International Conference on the Industrial and Agricultural Use of International Rivers, Art. 2, adopted at Montevideo, on 24 December 1933, *American Journal of International Law* 28/1934, 59–60.

[36] Diversion of the Water from the Meuse, Judgment, P.C.I.J. Series (ser. A/B) 70/1937, at 4 (June 28).

[37] *Ibid.*, 23.

[38] *Ibid.*, J. Hudson, individual opinion, 77.

fails to fulfill his part of an agreement cannot enforce that bargain against the other party).[39]

Back to our story, although it is clear, except for their purported embrace of customary law, that Bolivia and Chile have not assumed reciprocal obligations, this finding may change if they are found to share an aquifer or a river. The ICJ is known to impose a condition of equality between the parties and to require a mutually negotiated equitable accord. Thus, the practice of the court and its structural bias would push it for an interpretation of the watercourse as international if the common ownership of the aquifer is proven.

One problem with this argument is that the status of the community of interest standard in general international law still remains a subject of dispute. Doctrinal treatments vary with regard to conclusions about its maturation into a workable principle,[40] as opposed to an aspirational norm.[41] In case law, its treatment is strengthening, but also marked by notable ambivalence. For example, in the Gulf of Fonseca Case (1992), the ICJ Chamber concluded that the existence of a community of interest among Honduras, El Salvador, and Nicaragua was "not open to doubt" with regard to sovereignty over the waters of the Gulf of Fonseca.[42] The Chamber deemed a condominium or shared sovereignty arrangement involving Fonseca's waters "almost an ideal juridical embodiment of the community of interest's requirement of perfect equality of user".[43] The standard gained prominence in the ICJ's decision in the Pulp Mills Case

[39] C. R. Rossi, *Equity and International Law: A Legal Realist Approach to International Decision Making,* Martinus Nijhoff, Hague 1993, 161 − discussing the offensiveness of one party benefitting from its own illegal action and the *inadimplenti non est adimplendum* principle's close association with the *ex injuria jus non oritur* principle.

[40] B. Vitányi, *The International Regime Of River Navigation*, Springer, 1980, 56, which affirms the historical legal status of the "community of riparians" standard from the 1815 Act of the Congress of Vienna; J. G. Lammers, *Pollution of International Watercourses: A Search for Substantive Rules and Principles of Law*, Martinus Nijhoff, Brill 1984, 506, who affirms the community of interest standard from a review of the practice of states, dating to the Congress of Vienna; P. Wouters, "'Dynamic Cooperation' – The Evolution of Transboundary Water Cooperation", *Water and The Law: Towards Sustainability,* (eds. M. Kidd *et al*.), Edward Elgar, 2014, 62–65, who discusses the emergence of dynamic cooperation as a norm of integrated water resource management.

[41] S. C. McCaffrey, 167–171, notes that a community of interest falls far short of co-ownership, in the absence of an agreement making it so; A. Tanzi, M. Arcari, *The United Nations Convention on the Law of International Watercourses: A Framework for Sharing,* Springer 2001, 21, accentuates the voluntary nature of the community of interest; L. Caflisch, "Règles générales du droit des cours d'eaux internationaux", *Recueil Des Cours* 9/1989, 59–61, does not believe that this concept overcomes the limitations imposed by the rules of territorial sovereignty of states.

[42] Land, Island and Maritime Frontier Dispute (*El Sal./Hond.: Nicar. intervening*), Judgment, 1992 I.C.J. 351, 407 (Sept. 11).

[43] *Ibid*.

(2010), where the Court held a treaty-based commission: "established a real community of interests and rights in the management of the River Uruguay and in the protection of its environment".[44] The limited application of the community of interest standard nevertheless mandated that the commission "devise the necessary means to promote the equitable utilization of the river".[45] As held in the Case Concerning the Gabčíkovo-Nagymaros Project (1997), the unilateral diversion of a shared resource would deprive the other riparian of "its right to an equitable and reasonable share of the natural resource" and violate respect for proportionality (as implied by equality), "which is required by international law".[46] Although not in effect at the time, the Court took notice of the Watercourse Convention, which it claimed strengthened the development of the community of interest standard for non-navigational uses.

As far as primary sources are concerned, the community of interest standard and the principle of equitable utilization have been incorporated into the Cooperative Framework Agreement of the 1999 Nile Basin Initiative,[47] but the references also generated disputes regarding water security and current uses.[48] Other references can be found in the 2002 Senegal River Water Charter,[49] and the 2003 Protocol for Sustainable Development Lake Victoria Basin.[50] Within the Southern African Development Community (SADC), the community of interest standard was included in the 1995 Protocol on Shared Water Course Systems in the SADC Region, but was later retracted.[51]

Integral application of the community of interest principle in the pending case involving the Silala waters may apply even independently

[44] Pulp Mills on the River Uruguay (*Argentina v. Uruguay*), Judgment, 2010 I.C.J. Rep. 14., 281 (Apr. 20).

[45] *Ibid.*

[46] Gabčíkovo-Nagymaros Project (*Hungary v. Slovakia*), Judgment, 1997 I.C.J. 7, 851 (Sept. 25).

[47] Agreement on the Nile River Basin Cooperative Framework, Art. 3(4), (9) opened for signature May 14, 2010, *http://www.nilebasin.org/images/docs/CFA%20-%20English%20%20FrenchVersion.pdf*, last visited 20 2017.

[48] M. S. Kimenyi, J. M. Mbaku, "The Limits of the New 'Nile Agreement'", Brookings: Africa in Focus (28 April, 2015), *https://www.brookings.edu/blog/africa-infocus/2015/04/28/the-limits-of-the-new-nile-agreement/,* last visited 20 September 2017.

[49] Organisation pour la Mise en Valeur Du Fleuve Sénégal, Charte des Eaux du Fleuve Sénégal, pmbl., May 28, 2002, O.M.V.S., *http://lafrique.free.fr/traites/omvs_200205.pdf,* last visited 20 September 2017.

[50] Protocol for Sustainable Development of Lake Victoria Basin, Art. 4(2)(k), 29 November 2003, *http://www.internationalwaterlaw.org/documents/regionaldocs/Lake_Victoria_Basin_2003.pdf*, last visited 20 September 2017.

[51] C. R. Rossi, "The Transboundary Dispute over the Waters of the Silala/Siloli: Legal Vandalism and Goffmanian Metaphor", *Stanford Journal of International Law* 53/2017, 85.

from the aquifer connection. It would be very interesting to see whether the ICJ will be able to draw a parallel with its earlier decision in the Gulf of Fonseca case, since this parallel might enhance the position of the integrationist perspective of customary freshwater law. Although much discussion about the establishment of a community of interest derived from a specific conventional foundation, the ICJ Chamber noted in the Gulf of Fonseca Case that an earlier court, the Central American Court of Justice, had located a community of interest among Honduras, El Salvador, and Nicaragua (which was "not open to doubt") within the imperial and uninterrupted 300-year administrative rule of Spanish Viceroyalties.[52] That same system created the Viceroyalty of Peru, which contained both Bolivia (then known as Alto Peru) and Chile. Interestingly, the Chamber extended the community of interest standard in the Gulf of Fonseca Case to cover a condominium arrangement,[53] which essentially mandated that the coparceners cohabitate the space and craft through negotiated undertakings a managerial system. The rationale proffered by the Chamber clearly favored a pragmatic solution. Divisions of "narrow waters" and historic bays "into separate and unqualified sovereignties" present "great practical difficulties,"[54] as might the division of rivers and aquifers.

3.3. Vital Human Needs

Finally, in the event of a conflict over different uses of watercourses, states are required to take into special regard the vital human needs both in determining the equitable utilization of watercourses and in putting in place measures directed at preventing significant harm from being caused to other states.[55] According to the Statement of Understanding accompanying the Watercourse Convention, in determining vital human needs, "special attention is to be paid to providing sufficient water to sustain human life, including both drinking water and water required for production of food in order to prevent starvation".[56] In the words of one author "[c]odification for the protection of vital human needs ... leads to the progressive harmonization of water law and human rights law".[57] In

[52] Gulf of Fonseca Case (*El Salvador v. Honduras: Nicaragua intervening*), Judgment, 1992 I.C.J. 351, 407 (September 11).

[53] *Ibid.*, 418.

[54] *Ibid.*, 407.

[55] Watercourse Convention, Article 10(2).

[56] UN General Assembly Sixth Committee, "Report of the Sixth Committee convening as the Working Group of the Whole", Statements of Understanding Pertaining to Certain Articles of the Convention UN Doc (11 April 1997) A/51/869, para 8.

[57] C. Leb, "The Right to Water in a Transboundary Context: Emergence of Seminal Trends", *Water International* 37/2012, 648.

this vein, another well-known instrument in the field, the UNECE Helsinki Convention,[58] which has been ratified by 41 UNECE Member States and is open to all Members of the United Nations to accede to, has been supplemented by a Protocol that expressly requires states to pursue the aim of providing "access to drinking water for everyone".[59] Likewise, the Berlin Rules on Water Resources, adopted by the International Law Association in order to codify relevant rules in the field, stipulate that in the case of conflicting uses "states shall first allocate waters to satisfy vital human needs".[60] What is more, Article 17 of the Rules explicitly lays down the individual right of access to water.[61] Thus, it seems that no matter the international nature of the Silala River system, Chile would be entitled to claim respect for the international customary rights analyzed above. This entitlement runs counter to the claim by Bolivia to the use of 100% of the river's waters, grounded on the alleged domestic nature of the watercourse.

4. THE IMPLICATIONS OF CREATIVE INTERPRETATION FOR THE PURPOSE OF THE JUDICIAL FUNCTION OF THE ICJ

The three possible avenues for creative interpretation – aquifer connection, community of interest theory and vital human needs – join together to discard as unfounded the Bolivian claim that the Silala River is not an international watercourse, therefore affirming full sovereignty over the use and exploitation of its waters. The Bolivian claim very much resembles the theory of "absolute territorial sovereignty", also referred as the "Harmon doctrine", which is based on an intention to claim rights over shared resources that are exclusive and not related to any obligations – a view obsolete in the contemporary international system at face value. Needless to say, the Harmon doctrine favors upstream riparians (Bolivia in this case), which would be entitled to utilize, and even divert, waters

[58] Convention on the Protection and Use of Transboundary Watercourses and International Lakes (adopted 17 March 1992, entered into force 6 October 1996) (1992) 31 ILM 1312.

[59] Protocol on Water and Health to the Convention on the Protection and Use of Transboundary Watercourses and International Lakes (adopted 17 June 1999, entered into force 4 August 2005) (18 October 1999) UN Doc MP.WAT/2000/1, Article 6.

[60] ILA, Berlin Rules on Water Resources, adopted by the International Law Association at the Berlin Conference on Water Resources Law on 21 August 2004, *https://www.internationalwaterlaw.org/documents/intldocs/ILA_Berlin_Rules-2004.pdf,* last visited 20 September 2017, Article 14(1).

[61] *Ibid.*, Article 17(1): "Every individual has a right of access to sufficient, safe, acceptable, physically accessible, and affordable water to meet that individual's vital human needs".

without regard to the implications on other downstream countries.[62] In light of the above considerations, a straight claim of the exclusive right to use and exploit the portion of waters of an international river located within its own boundaries would have had few chances to succeed before the ICJ, while the qualification of the Silala River as a domestic one leaves Bolivia room to assert full sovereignty and a lack of obligation towards neighbor countries.[63]

This case proves an old saying that international rivers can be catalytic agents of cooperation on multiple riparian levels and may also enable integration and pragmatic "cross border cooperation beyond the river".[64] But, the other side of this saying claims that "international rivers, without exception, create some degree of tension among the societies that they bind".[65] Be that as it may, the point of this case is that two sovereign parties have sought recourse to international law in the dispute whose solution has been impeded by the historical context of the watershed, the existing diplomatic situation between them, and the lack of an agreement on whether or not the Silala River is an international watercourse.[66] The Silala Basin is designated by security experts as the only "high risk" basin in South America and "one of the most hydropolitically vulnerable basins in the world".[67] On the other hand, the ICJ exists to

[62] This doctrine was first affirmed in 1895 by the US Attorney General, Judson Harmon, in the context of a dispute between the USA and Mexico over the use of the Rio Grande. However, today it is outdated and incompatible with principles of cooperation and good neighbourliness between all states that are members of the UN. Furthermore, McCaffrey doubts that such a doctrine has ever existed in International Law, because even in the dispute in which it originated was not used as the final basis for settlement. See S. C. McCaffrey, "The Harmon Doctrine One Hundred Years Later: Buried, Not Praised", *Natural Resources Journal* 36/1996, 549.

[63] It is doubtful whether Bolivia can claim full sovereignty in one more aspect. While acknowledging the significance of the consequences that follow from the clarification of the legal nature of the River, in light of the current evolution of international law, it can be argued that the human right to water limits the states' right to fully dispose of their water resources in any event. As one author notes: "The waters of the Silala River system are used in Chile for industrial purposes as well as for the provision of water supply for human and domestic use. As for the latter, one might wonder whether a State claiming full sovereignty over the use and exploitation of a river could be considered completely unbound from any extraterritorial obligations vis-à-vis people who, while outside its territory, depend on the same waters", R. Greco, "The Silala Dispute: Between International Water Law and the Human Right to Water", *Questions of International Law* 39/2017, 28.

[64] C. Sadoff, D. Grey, "Beyond the River: The Benefits of Cooperation on International Rivers", *Water Policy* 4/2002, 399.

[65] *Ibid.*, 391.

[66] UNEP, "Hydropolitical Vulnerability and Resilience along International Waters", Nairobi, UNEP Publications, 2007.

[67] *Ibid*.

facilitate the peaceful settlement of disputes. This is an opportunity for the ICJ to clear the substance of the law in the direction which strengthens its object of protection – water resources, but at the same time to encourage a slow but steady trend of states referring transboundary fresh water disputes to the ICJ or to arbitration.[68]

If the argumentation of Bolivia would prevail, this would mean that a watercourse which physically crosses a border between two countries that are not really known for good bilateral relations is left to its exclusive management. This is a solution that might produce further complications in the future, and it certainly does not fall under the category of dispute settlement, but rather dispute prolongation. The physical fact is that the natural resource is shared, thus the legal solution must not ignore this fact of life and hold stubbornly to the narrow interpretation of the notion of the international watercourse which nonetheless does not have any other support in practice or theory other than plain inertia. The ICJ is presented with a great opportunity to settle a dispute and, even more importantly, to create a platform of cooperation for two countries which are sorely in need for cooperative arrangements. And this opportunity would be used just by interpreting the provisions of international water law systematically and creatively, plainly speaking – by thinking outside the box. This is because of the fact that the rules for management of international watercourses are based on cooperation, mutual providing of information, respect for the environment, prevention of harm to any of the riparians, and finally equity and reason – all of which represents the single idea that riparians share an interest in the well being and usefulness of something that is common, no matter how this something came into existence.

5. CONCLUSIONS

Back in 2010, when this author started researching his PhD thesis, which dealt with law of non-navigational uses of international watercourses, the Pulp Mills Case was before of the ICJ as only the second such case at this institution, and the Watercourse Convention was yet to enter into force. Nowadays the ICJ has three pending cases of the same topic and an increase in arbitrations, and interest by legal scholars in this topic is increasing exponentially around the globe. It seems to me that this certainly has to do with the rising awareness of the subjects of international community about the strategic importance of fresh water as a

[68] T. Meshel, "A New Transboundary Fresh Water Dispute before the International Court of Justice", *Water International* 42/2017, 95. She cites a recent example in this regard – the Indus Waters arbitration between India and Pakistan.

resource. In line with this is the fact that a dispute between two countries that otherwise have no shortage of fresh water on their respective territories has arisen concerning a watercourse only 8 km long. And this dispute is even more threatening for international peace and security when regarded in the wider context of the geopolitical game of prestige, which these two countries have been playing for over a century. Whether the decision of the ICJ would contribute to the relaxation of tensions and imply a path towards a future more focused on cooperation than conflict between the parties is unknown at the moment. However, what is obvious is that the legal rules in this field still need to be developed and finely tuned, and there is no better way to do this than to first clarify the basic concepts which these rules use in their legal technique. Therefore, the question of what is an international watercourse, as the primary object of regulation of these rules, comes as the mother of all questions. And this dispute is essentially about that, and it is obvious that the existing rules do not give us a straight answer, but rather the answer must be sought through interpretation, which includes a dose of creativity and awareness of the purpose of the rules. We have demonstrated that various paths of interpretation of these rules lead to the same conclusion which can be summarized as follows:

a) artificially created transboundary watercourses, which flow on the surface, must be regarded as objects of international law if their subsurface parts (groundwaters) – which "by virtue of their physical relationship" constitute "a unitary whole" – still flow naturally over the same border. This is the logical interpretation of the purpose of Article 2 of the Watercourse Convention, which gives a definition of an international watercourse;

b) artificially created transboundary watercourses still can be regarded as objects of international law because the spirit of community of interest, which underlies the customary rules of international law in this field, requires the application of these rules to shared water resources no matter their origin (natural or artificial);

c) even if first two arguments fail to impress the ICJ, there is still the express special status of vital human needs as a factor that determines the equitable utilization of watercourses and measures directed at preventing significant harm from being caused to other states. This factor comes into play even if the evidence prevails that Bolivia can claim ownership of 100% of the surface waters of the Silala Basin, therefore it requires some form of cooperation of the states over the physically shared resource, regardless of its ownership.

Finally, the purpose of the judicial function of the ICJ is to settle international disputes in the interests of international peace and security. Thus, it must take into consideration that the inevitable consequence of adjudicating to Bolivia the exclusive right of management of the Silala watercourse would further aggravate the situation in this region. It would give Bolivia legal grounds for unilateral action, which might not prove to be in the best interest of the people who depend on the Silala water resources, on both sides of the border. On the other hand, creating a cooperative platform on the basis of international legal rules on water resources, might contribute to the promotion of common interests among the riparians and general improvement in their relations. This would in turn lead to general relaxation of the tensions in the region and further establish international law as a vehicle for management of water resources.

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UNITED NATIONS INTERNSHIP PROGRAMME POLICY AND THE NEED FOR ITS AMENDMENT

An internship at the United Nations is an opportunity that young people interested in international law, international relations, and many other fields, perceive as he best possible career starting point – and rightfully so. The United Nations internship is an experience second to none in the world of international organizations and this is why it must be available to the widest range of people, regardless of their status, place of birth and social context. However, the current United Nations internship policy is very controversial and in desperate need of a change. While voices for change of policy are raised more and more, this topic has been very rarely addressed in academic literature across the world and papers and books dealing exclusively with this issue are almost non-existent. In this article, the author will address the main points of the concern regarding unpaid internship and will offer potential solutions for its improvement. This article is a humble contribution that will hopefully instigate wider academic acknowledgment of this problem and eventually contribute to the resolution of this unfortunate practice.

Key words: *Internship. − United Nations. − Policy. − Fair. − Amendment. − Unpaid. − Least Developed Countries (LDP).*

1. INTERNSHIP AS A GENERAL NOTION

The informal notion of internship was present in some form probably since the first jobs emerged, but one of the first normative acts to formally institutionalize it, was the Fair Labor Standards Act passed in the United States in 1938.[1] US president Franklin Delano Roosevelt considered it "the most far-reaching, farsighted program for the benefit of

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workers ever adopted in this or any other country."[2] This law was passed during the Great depression and it aimed to protect the rights of workers through the introduction of a minimum wage, preventing long working hours without appropriate remuneration and child-labor.[3]

An internship is a very important, initial career step and intern's benefits are numerous. Interns can gain experience, develop skills, make connections, strengthen their resumes, learn about a field and assess their interest and abilities. Because of all these opportunities, the selection process for interns must be highly transparent and based solely on the quality of the candidates. This is especially true and important for the United Nations, the organization that has, since its founding in 1945 been a leader in the struggle to make the world a better place.[4]

2. UN INTERNSHIP

In the UN system, interns are still classified under a decades-old administrative instruction known as "gratis personnel" – a term originally invented for peacekeeping troops lent by governments to the organization.[5] Gratis personnel are staff loaned to the United Nations, free of charge, by Member States. General Assembly resolution 51/243 of 15 September 1997 prescribes the circumstances under which such personnel may be utilized. Although interns constitute the majority (89.4% according to a 2014/2015 report) of the "gratis personnel" there are also other groups included into this designation such as associate experts, technical cooperation experts and a heterogeneous group classified as Type II.[6]

2.1. UN Intership and the selection of the best

Since the League of Nations and the first years of the United Nations, one of the most important goals, in the formation of the administrative apparatus, was to attract as many top level experts as possible. At a

[1] C. Durrant, "To Benefit or Not To Benefit: Mutually Induced Consideration As A Test For The Legality Of Unpaid Internships", *University of Pennsylvania Law Review* 1/2013, 169.

[2] L. Fitzpatrick, "The Minimum Wage", *Time*, July 24/2009, *http://www.time.com/ time/magazine/article/o, 9171,1912408,00. Html*, last visited 29 October 2017.

[3] E. M. Dodd, "The Supreme Court and Fair Labor Standards, 1941−1945", *Harvard Law Review* 59/1946, 321.

[4] J. Fomerand, *The A to Z of the United Nations*, The Scarecrow Press 2009, vi.

[5] Composition of the Secretariat: gratis personnel, retired staff and consultants and individual contractors Report of the Secretary-General, A/71/360/, 12−86.

[6] *Ibid*.

time, the League of Nations was a new organization, the first "international" and "global" institution. As such, employees of the League of Nations and in early years of the UN had to have, in addition to their job qualifications, certain dose of adventurism and intrinsic altruism. Employment in the League of Nations or the early days of the United Nations represented a risk of devoting years to a new and thus insecure environment for a greater cause (world peace and equality).

The United Nations have repeatedly addressed the issue of economic inequality stating that "one of the greatest discrimination in this world today is discrimination by rich people against poor people.[7] This firm position comes with a responsibility as well, because the UN has to implement proclaimed values within its own system. Unfortunately, in the case of internships, these economic equality considerations while formally adhered are *de facto* are violated.

The reason for this conclusion relies on the fact that internships at the UN are not paid positions. Since internships are not paid, the interns must obtain means of funding their own accommodations, meals, transportation, health insurance and all other costs. The provision of the UNDP, similar to the provision of almost every UN agency confirming this policy, states "UNDP does not pay for internships. The costs associated with the latter must be borne by the nominating institution, related institution or government, which may provide the required financial assistance to its students; or by the student, who will have to obtain financing for subsistence and make his or her own arrangements for travel, accommodation etc.".[8]

By not providing any financial support for the internship, there are a very limited number of people who can get the internship position. Selection process for the internship positions should be highly competitive, but main condition must be quality of the candidate not its wealth. Although the possibility of becoming an intern is theoretically available to everyone, it is actually limited to roughly three groups. First are the ones belonging to the very limited portion of a population whose families and general surroundings of their upbringing can provide them with sufficient funds to spend several months or more in an expensive cities such as Vienna, New York or Geneva. The second group is made of the people who live in the vicinity of above-mentioned cities (and other cities where UN offers internship programmes), so that they do not have to pay the accommodation and travel costs. The third group includes young people able to obtain funds from third parties (not themselves or the UN). This

[7] J. Carter, B. Boutros-Ghali (eds.), *Conference for Global Development Cooperation: Meeting Report*, DIANE Publishing, 1992, 9.

[8] *http://www.undp.org/content/undp/en/home/operations/jobs/types-of-opportunities/internships.html*, last visited 29 October 2017.

sponsor can be their government, some international foundation, etc. A good example of this is Germany, where UN interns are supported by the Carlo-Schmid Programm.[9] However, although this is the only one out of the three mentioned possibilities that actually provide some kind of merit-based selection, the issue remains that in the case of sponsorships somebody else is choosing interns for the UN.

It is obvious that according to the current internship policy, internship positions are *de facto* reserved mostly for young people coming from the Western countries or other most powerful economies. Just a casual glance at the list of countries with more than 100 interns in 2015 will demonstrate this. Moreover, this list offers a clear correlation between the wealth of the countries from which the interns are coming and their sheer number. There are 13 countries that provided 100 or more interns in 2015. The leader on this list was China 517 with interns, followed by the USA (434), France (314), Kenya (278), Germany (226), Italy (174), Canada (167), South Korea (159), the United Kingdom (140), the Russian Federation (135), Australia (133), Chile (107) and Spain (102).[10] Despite the fact that interns are not part of the UN administration, one cannot neglect the fact that UN charter provision stating "...Due regard shall be paid to the importance of recruiting the staff on as wide a geographical basis as possible"[11] is bluntly ignored when it comes to the internship positions.

On this list we can see two countries that clearly stand out – Chile and Kenya. These two countries are far from the rest of the group when it comes to the economic power, GDP and other economic parameters. The reason why those two countries are on the list, is not an effort to conform to article 101(3) of the UN Charter. Interns from Kenya and Chile are so numerous because their countries host UN offices that have internship programmes – one is in Santiago de Chile and the other one is in Nairobi (other main locations being New York (United States of America), Geneva (Switzerland), Vienna (Austria), Addis Ababa (Ethiopia), Bangkok (Thailand), Beirut(Lebanon)).[12] For the same reason, there were 65 interns from Lebanon compared to only 2 interns from Costa Rica, despite the fact that those two countries have roughly the same GDP.[13] Finally, there are some states that are so poor that their nationals are almost entirely prevented from doing internships despite the fact that they

[9] *https://www.studienstiftung.de/carlo-schmid/*, last visited 29 October 2017.

[10] Engagement of type I gratis personnel, by nationality, category and gender: 2014−2015, Composition of the Secretariat: gratis personnel, retired staff and consultants and individual contractors Report of the Secretary-General, A/71/360.

[11] Article 101(3), UN Charter.

[12] *https://careers.un.org/lbw/home.aspx?viewtype=IP*, last visited 29 October 2017.

[13] *https://unstats.un.org/unsd/snaama/dnlList.asp*, last visited 29 October 2017.

have internship programs available within their country – Ethiopia had only 10 interns. This picture demonstrates direct correlation between economic power of the countries and number of interns. Aside from already mentioned disadvantage of people of lower economic status, current UN internship policy programme gives unequal and unfair treatment to the nationals of the poorest countries and this issue must be addressed rapidly – less than 6% of all the interns come from the least developed countries.

Apart from this main reason for the amendment of the internship programme policy, and that is equality, there is another argument for the change that solely relates to the UN administration. The UN administration frequently reports the departure of the most promising young interns.[14] This is a logical consequence of the fact that UN internships are unpaid. The United Nations is the largest and the most important international organization and for many students of international law, international relations and many other disciplines, working for the UN is a dream come true. Hence, they are willing to do the internship for free, pay for all the costs or even live in a tent during the internship.[15] However, after some time, interns often find financially better options or just opt-out to take the next step outside of the UN. By paying interns, the United Nations would be able to keep the best experts within their own administration.

2.2. Employment during the internship

In addition to the fact that UN is not paying its interns, there is also the ban on taking any job during the internship.[16][17] Currently, the option for the hardest working people to take a job in order to cover the costs of their internship is also excluded as a possibility.[18]

Working alongside the internship would be a very demanding task – but let it be, at least as an option. The best candidates are not only the most educated or only the most intelligent ones – they have to be the hardest working as well. According to some studies, 5% of the USA pop-

[14] *https://www.economist.com/blogs/economist-explains/2015/08/economist-explains-15*, last visited 29 October 2017.

[15] *https://www.theguardian.com/global-development-professionals-network/2016/aug/22/when-will-the-united-nations-address-its-unjust-internship-policy*, last visited 29 October 2017.

[16] *http://www.aljazeera.com/indepth/opinion/2013/05/20135371732699158.html*, last visited 29 October 2017.

[17] *https://careers.un.org/lbw/jobdetail.aspx?id=57411*, last visited 29 October 2017.

[18] *http://www.undp.org/content/undp/en/home/operations/jobs/types-of-opportunities/internships.html*, last visited 29 October 2017.

ulation is working two or more jobs, with the apparent growing tendency.[19] However, a statistic that is more relevant to the topic of this article is the one that focuses on the student population and their ability and willingness to multi-task and numbers are very convincing – over 80% of students are working while studying.[20] According to another survey, conducted by NUS Services on behalf of Endsleigh, 77% of students work to fund their studies, with 63% having a part-time job and a third working during the term.[21] No one can overlook the willingness of the young people to devote a lot of time and a lot of hard work for the career of their dreams. Working alongside UN internship, will make some interns to realize that that is too much for them. Without any doubt, some interns would drop out, but it is of the utmost importance to provide an option for that. The fact that we are living in the era of internet and wireless communication, where commuting is not necessarily part of the job makes the reasoning behind the decision not to allow jobs during the internship highly questionable.[22]

3. INTERNSHIP IN PRIVATE SECTOR

Unlike the United Nations, large companies in the private sector do not perceive their interns as a source of cheap (or more accurately free) labor force. Interns are seen as an enormous potential for the company – an investment in the future. Behind this attitude there is no altruism or consideration for the wellbeing of young generations – but sheer benefit of the company. At least two aims are achieved this way: the employer has the opportunity to take into its system young, talented persons while their market value and demands are still low. Secondly, bringing interns of a young age into the company enables the employer to further develop their skills in accordance with the company's needs. This is why interns are paid in large and most successful corporations. Here are just several examples of the largest companies (ones from the information technology industry) and remuneration they are giving to their interns: Dropbox: $8,735/month, Google: $7,185/month, Facebook: $7,109/month, Microsoft: $6,751/month, Apple: $5,618/month.[23]

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[19] *http://www.bls.gov/cps/cpsaat36.htm*, last visited 29 October 2017.

[20] *http://www.marketwatch.com/story/nearly-4-out-of-5-students-work-2013–08–07*, last visited 29 October 2017.

[21] *https://www.theguardian.com/education/2017/mar/31/working-while-studying-how-can-i-get-my-social-life-back*, last visited 29 October 2017.

[22] *http://www.icty.org/x/file/jobs/Internship%20Forms/internship_faqs_en.pdf*, last visited 29 October 2016.

[23] *http://www.businessinsider.com/high-paying-tech-internships-2016–3*, last visited 29 October 2017.

Even if we put aside multi-billion I.T. corporations, many state-owned institutions and departments are also providing some kind of remuneration – often similar to the minimum wage, such as Public Defender Service.[24] On the top of this, Public Defender Service offers other benefits as well.[25] It is obvious that UN cannot match internship remuneration paid by the I.T. giants, but the culture of appreciation is something that the UN must nurture as well. Working within the UN system requires certain skills and it is different from almost any other job. Consequently, somebody coming to the UN in their middle age must go through a period of transition and adjustment to the system and this period is not needed for someone who started as an intern.

In this comparison with private enterprises, already-mentioned special status of the UN cannot be neglected. The United Nations is not a private enterprise whose sole interest is its own benefit and profit. The UN is a role-model, whose reputation rests on four pillars: impartiality, equity, efficiency and achievement – with a fifth one often added – independence.[26] These values have to be incorporated within the internship policy as well.

4. UN INTERNSHIP AS A ROAD TO A JOB

There is a ban applied on employment in the UN for six months after the internship. The provision that indicates this practice states as following: "The Internship Programme is not related to employment in the United Nations. There should be no expectation of employment within the UN after an internship. Interns shall not be eligible to apply for, or be appointed to, positions at the professional level and above carrying international recruitment status in the Secretariat for a period of six months following the end of their internship."[27]

The above-cited provision is a general rule for all UN-related internships – no expectations of employment. Purpose of this provision is to decrease the connection between the internship and the UN employment. If the UN internship really did not increase the chance of UN employment, then the fact that the internship is not paid would still be wrong, but without such drastic consequences for both the UN and interns.

[24] *http://www.pdsdc.org/careers/criminal-law-internship-program*, last visited 29 October 2017.

[25] *Ibid*.

[26] M. Froehlich, *Political Ethics and the United Nations: Dag Hammarskjöld as Secretary-General*, Routledge, 2007, 205.

[27] *http://www.unescap.org/jobs/internships-faqaccessed*, last visited 29 October 2017.

However, the fact that internships can lead to UN employment (in practice, often the first step after an internship is a consultant position) is obvious from the description of the duties and obligations of the interns. For example, it is stated that the intern will be "...working directly with outstanding and inspiring career professionals and senior management".[28] Even general provision states: "The objective of the internship is to give you a first-hand impression of the day-to-day working environment of the United Nations. You will be given a real chance to work with our people. As part of our team, working directly with outstanding and inspiring career professionals and senior management, you will be exposed to high-profile conferences, participate in meetings, and contribute to analytical work as well as organizational policy of the United Nations. Initially you will take on the amount of responsibility you can shoulder; the potential for growth, however, is yours to develop".[29] Provisions enabling interns to acquire valuable connections during the course of the internship are not restricted to the general documents, but can also be found in the localized policies. One of the features of the UN internship in the USA includes "inviting members of the United Nations, Permanent mission to the U.N. and UNA-USA senior staff to address subjects determined by the interns".[30]

It is obvious that there is a possibility for a good and hardworking intern to create a network that would help him in the future career. There is nothing wrong to give an intern the possibility to create networks and hence pave the way to the UN appointment. Moreover, this is what an internship should look like and it should present a possibility for the best interns to stay permanently in the UN system. However, the issue lies within the fact that this opportunity is given only to those wealthy enough or ones living within the vicinity of the UN offices providing the internship programs.

5. POTENTIAL SOLUTIONS

Criticisms coming from numerous organizations and individuals regarding this unfair internship practice are not by any means new, but these voices have been raised more often in recent years. Even former US president Barak Obama raised his voice against unpaid internship in the USA.[31] The United Nations response to these complaints is rather contro-

[28] *https://careers.un.org/lbw/home.aspx?viewtype=IP*, last visited 29 October 2017.

[29] *Ibid*.

[30] S. Hamadeh, *Vault Guide to Top Internships*, Vault, 2004, 402.

[31] Brann & Isaacson, "Hiring Unpaid Interns: Advice for Employers", *Maine Employment Law Letter* 2011, 4.

versial. The General Assembly resolution banning the payment of interns was stated as the formal reason that prevents UN from amending the non-payment practice. Later, it was revealed that there is no rule vested in a resolution preventing financial aid to interns.[32] Only such provision might be the one that places interns in the "gratis personnel" classification. However, there is absolutely no provision that forbids the UN from altering their status or changing the classification. The position and duties of interns have evolved over time and their role is much different now than when the "gratis personnel" class was formed. From a financial standpoint, the United Nations insisted that there are simply no funds available to be allocated for interns. However, the Secretariat recently filed a request to the General Assembly, recommending the raise of the staff wages for 10%.[33] Obviously, there are possibilities for allocation of more funds to the (not so low) UN staff wages. According to some estimates, covering all interns' costs would require less than 0.5% of the current UN budget.[34] Many other international agencies solved this issue despite the fact that they have much smaller budgets. One can take as an example the ILO (that has budget of 801.860.000 $[35] compared to the UN's 5,4 billion dollars[36]), which made a significant changes to its policy. The ILO provision regarding internship states that "where an intern is not supported by an institution (university, government or other institution), a stipend to cover basic subsistence costs will be paid by the ILO."[37] Furthermore, Interpol is remunerating 550 EUR per month for the interns in Lyon and similar contribution is provided to the interns stationed in different duty stations.[38]

Ideas for amending the UN internship policy are numerous but crucial element in this endeavor is still questionable – is there a will for the change within the United Nations' administration? In order to introduce paid internship positions there are at least two applicable models that would demand fewer funds than financing every intern. One option is to

[32] *https://www.theguardian.com/global-development-professionals-network/2016/aug/22/when-will-the-united-nations-address-its-unjust-internship-policy*, last visited 29 October 2017.

[33] *https://www.theguardian.com/global-development-professionals-network/2016/aug/22/when-will-the-united-nations-address-its-unjust-internship-policy*, last visited 29 October 2017.

[34] *Ibid*.

[35] The Director-General's Programme and Budget Proposals For 2016–17, 323rd Session, Geneva, 12–27 March 2015, 69.

[36] Fifth Committee (Administrative and Budgetary) budget for the United Nations for the 2016−2017 biennium.

[37] *http://www.ilo.org/public/english/bureau/pers/vacancy/intern.htm#q4*, last visited 29 October 2017.

[38] *https://www.interpol.int/Footer-extranet/Recruitment/Other-recruitment-pages/Internships*, last visited 29 October 2017.

provide paid internship only for candidates coming from the poorest countries. The list of those countries does not need to be created – the UN can use its list of the LDC's, which currently has 47 countries within.[39] The second option that would be in line with the UN standards would be establishing paid intern positions for the best candidates, regardless of their (or their countries') economic status.

Apart from those, in author's opinion the fastest and the most practical ways of amending current internship policy, there are at least two more options, but one of them requires a lot of time and the other one a lot of effort and "tectonic" changes within the UN system. The first idea is to give more time to the UN to develop and eventually establish the practice of remunerating interns. Although these processes within the UN system can be very lengthy, there are examples of changes being made over a time. Good example is the one of the colonial countries.[40] Those countries had lengthy independence struggle before and after the World War II,[41] but at the end through numerous resolutions, the United Nations paved the path to their independence. The second option is the reform of the entire UN system. It is obvious that UN system is in desperate need of a change – the only question is how big the overhaul should be and how to achieve it. Some authors suggest that the reform should start from the Security Council;[42] others are proposing the reform of the appointment procedure of the Secretary General[43] or advocating for some other solutions.[44] However, in order to analyze alteration of the internship policy within the more comprehensive change of the UN system, separate and much bigger and more detailed analysis is needed.

6. CONCLUSION

As it was already pointed out in this article, understanding the importance of interns and respecting their contribution is a very important task. The UN has an added level of responsibility towards young people

[39] *https://www.un.org/development/desa/dpad/least-developed-country-category.html*, last visited 29 October 2017.

[40] Colonial countries are countries of origin of many "potential" interns that are currently in disadvantage.

[41] B. Milisavljević, "Diplomatska zaštita u međunarodnom pravu i Ujedinjene nacije", *Zbornik Matice srpske za društvene nauke* 4/2013, 672.

[42] More on that in D. Dimitrijević, *Reforma Saveta bezbednosti Ujedinjenih nacija*, Institut za međunarodnu politiku i privredu, Beograd 2009.

[43] More on that in M. Novaković, "Some Remarks Regarding the Procedure of the Appointment of the Secretary General of the United Nations", *Annals of the Faculty of Law in Belgrade* 3/2016, 171−191.

[44] More on that in J. Muller (ed.), *Reforming the United Nations – The Struggle for Legitimacy and Effectiveness* Martinus Nijhoff Publishers, Leiden – Boston, 2006.

– because of the UN's role-model position to many organizations, states and even individuals. The United Nations constantly emphasizes the importance of achieving equality in various fields[45] and we can see this aim proclaimed within the Sustainable Development Goals in goal number 10[46] and especially within the goal 4.5. Goal number 4.5., stresses the need to "eliminate gender disparities in education and ensure equal access to all levels of education and vocational training for the vulnerable, including persons with disabilities, indigenous peoples, and children in vulnerable situations".[47] The United Nations cannot fail at the first step, in the first contact with young people – and the internship is just that. The organization of the United Nations must be the prime example of the implementation of the values[48] that it advocates for. Providing an equal opportunity for all young people is beneficial and important not only for young people around the world striving towards working in the UN (or at least familiarizing with its system), but also for the United Nations as an organization.

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[45] T. G. Weiss *et al*., *The United Nations and Changing World Politics,* Westview Press, 2016, 388.

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[47] S. Yamada, "Asian Regionality and Post-2015 Consultation: Donors' Self-Images and the Discourse", *Post-Education-Forall and Sustainable Development Paradigm: Structural Changes with Diversifying Actors and Norms* (ed. A. Wiseman), Emerald Group Publishing Limited, 2016, 115

[48] S. Browne, *Sustainable Development Goals and UN Goal-Setting,* Routledge, 2017, 108.

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IMPOSSIBLE ESCAPE: INQUISITOR JACQUES FOURNIER AND THE TRIALS OF THE CATHARS AT THE END OF THEIR EXISTENCE IN LANGUEDOC

Analyses of cases contained in the Register of inquisitor Jacques Fournier (1318–1325) allude to the difficulty of a suspect leaving the inquisitorial trial without a sentence in the form of penitence. Having in mind the sentiments of contemporaries regarding the trials and the current multidisciplinary scholarship on the subject, the author investigates the changes Fournier that made in the system, through analysis of three cases least-related to heretical dogma. The author came to the conclusion that: 1) early centralization of medieval France facilitated alterations of the inquisitorial process, 2) the inquisition started regarding heretical certain deeds (and often even thoughts) that had previously not been considered heretical, by linking simple unacceptable behaviour to elements of heretical beliefs.

Key words: *Inquisitorial trials*. – *Jacques Fournier.* – *Catharism.* – *France.*

1. INTRODUCTION

Jacque Fournier, the Bishop of Pamiers, commenced inquisitorial career against the heretics in southern France when the region's largest heretical movement was fading. At the beginning of the fourteenth century, Catharism held a fraction of the power that it represented before Montsegur fell and the bloom of the movement had passed. Fournier dealt the last blow to Catharism through zealous inquisitorial processes against all elements that might have resembled Cathar teaching. The ex-

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tinction of Catharism in Languedoc is causally related to the observation that it was almost impossible for an accused, who was supposed to 'talk' and 'confess' about himself and others, to leave the inquisitorial process without a sentence. This was also influenced by changes in the system of the French inquisition in the early 14th century. This was truer for the elements connected to the inquisitorial process, which in its nature was a court process.

Although the majority of historians studying late Catharism in Languedoc believe that medieval inquisition was not particularly bloody,[1] sentences were unproportionally tough and once the accused entered the system it was impossible for them to leave without penitence, which had the characteristics of a sanction.

In order to illustrate and analyse the issue convincingly, the paper will consider particularities of Fournier's inquisitorial procedure. With the aim of a better contextualization, the paper will consider features of the inquisitorial process and examine inquisitorial texts, which influenced the formation of the very procedures and the construction of the heretical identity. The issue will be presented in the paper through the analysis of three case studies from Fournier's *Register,* which covers the period from 1318 to 1325. The chosen cases have the least connection to the Cathar teachings or other dogmas, which the Catholic Church deemed heretical. It needs to be acknowledged that Michel Foucault's methodological approach in construction of the 'other', and his discourse on the relationship between power and knowledge, is featured in the works of several recent historians of Catharism.[2]

2. THE INQUISITION AND INQUISITORIAL TRIBUNALS IN LANGUEDOC AND THEIR PRACTICE

It needs to be mentioned that there was no single inquisition headed by the Great Inquisitor in the Middle Ages. The inquisition in Medieval France consisted of a number of tribunals, led by the Franciscans or Dominicans, or by local bishops, as it was the case with a tribunal of Pamiers, where Jacques Fournier was the bishop. Regardless of the lack of the institutionalized inquisition, all tribunals shared certain features: the inquisitors were directly responsible to the Pope; they commenced the trials ex-officio against those who were either accused of heresy or the inquisitors suspected them of heresy; processes were secret, just as were

[1] J. Given, "The Inquisitors of Languedoc and the Medieval Technology of Power", *The American Historical Review* 94(2)/1989, 353; J. Given, *Inquisition and Medieval Society. Power, Discipline, and Resistance in Languedoc*, Ithaka, 1997, 66–90.

[2] R. I. *The Formation of a Persecuting Society*, Oxford 2007.

the identities of those who testified against the accused; and finally, the condemned person could not appeal the inquisitors' decision.[3] It is generally accepted that the accused had no right to counsel, which can be found in *Practica*, the manual created by inquisitor Bernard Gui, where it is stated that "the inquisitor can commence...without lawyers' supervision".[4] Jean Duvernoy claims that there were exceptions when lawyers were present, although he concedes that their presence was not of tremendous significance to the victims of the inquisition.[5] The inquisitorial process was also made easier when at the end of the 12th century procedure replaced accusation. Furthermore, by this time the inquisitorial procedure had become part of the church courts, which enabled the judge to take action against those suspected only on the basis of rumors.

The Dominicans established two inquisitorial tribunals in Languedoc: one in Toulouse and another in Carcassonne, which was assisted by the bishop tribunals in Carcassonne, Albi, and Pamiers.

The facilitation of inquisitorial procedures, their strengthening, as well as eventual transformation and alteration, needs to be understood as a method used by the political authorities to legitimize themselves at the times of preliminary centralization, manifested in the development of the state system during the period of the High Middle Ages.

The French inquisition invented new ways of manipulating its subjects. James Given offered a detailed analysis of techniques, which were used by the inquisitors in Languedoc in the suppression of heresy, both of those taken from the state authorities and those organic to the Catholic Church, developed over centuries of fighting the heretics. Among these, prisons should be mentioned here, which were employed frequently as punishment, since Church institutions were not allowed to order 'spilling of blood'. The reality that this observation is more than the fruit of historians' construction is apparent from the fact that one of the three most important inquisitors in Languedoc, Bernard Gui, in his *Practica*, advised his collegues that a stay of several years in prison led even the most headstrong to confess. In addition to the fact that a long stay in prison affected the accused in a psychological manner, due to the isolation element, the psychological pressure could be further manipulated by denying prisoner food and putting him in the shackles, which would further restrict their already limited mobility.[6] Given emphasizes the creation of inquisitorial

[3] See: E. Griffe, *Le Languedoc Cathare et l'Inquisition 1229–1329*, Paris 1980.

[4] B. Guidonis, *Practica inquisitionis heretice pravitatis auctore Bernardo Guidonis* (ed. C. Douais), Paris 1886, 192.

[5] J. Duvernoy, "La Procedure de Repression de l'Heresie en Occident au Moyen-Age", *Heresis* 6/1986, 50.

[6] B. Gui, *Manuel de l'inquisitor*, 1−2 vols. (ed. and trans. G. Mollat), Paris 7/1926, 1, 182−3.

registers, which document and follow all idiosyncracies in confessions, and which were used for future reference. The very existence of the registers of the inquisitional processes, as well as the manner of their use, became the objects of knowledge, which further empowered the system of the inquisition.[7]

The amalgamation of the techniques employed by the inquisitors, which was founded on the interdependence of knowledge of the 'object' of the inquisitorial trial and power over it, found their expression in the construction of the heretic and creation of an appropriate reality. James Given and John Arnold employed the idea of the construction of the 'other' in their studies of the functioning of the inquisition in Languedoc.

3. A HARLOT, A SODOMITE AND A REACTIONARY TO THE CHANGES IN THE FEUDAL SYSTEM

This part of the paper analyses three case studies from Jacques Fournier's *Register* in order to demonstrate the impossibility of remaining unpunished, as well as why the weight of punishment seemed unfair to contemporaries and disproportionate to historians. The chosen cases are the least connected to the idea of the Cathar teachings i.e. the deponents in these cases offered the least material linked to activities which, up until Jacques Fournier's time, had been considered heretical.[8]

It should be mentioned that the construction of 'the heretical identity' did not start with Fournier and his inquisitorial work. The idea of those who could be considered heretics had been constructed in the period of a couple of centuries during which the Catholic Church in the south of France fought against the Cathar movement. The Church desired to know the exact beliefs which were held by the heretics and what were the points in which it deviated from the orthodoxy. With this in mind, the *Manuals* were created, which defined actions and relations that were taken to be heretical. A great majority of the society was acquainted with the construction and their possible defence in the trials was founded on this knowledge. One of the main actions for which an accused could be sentenced for penitence was 'seeing' *prefect*. A number of other actions followed this one, such as assisting the Cathars materially, sheltering them,

[7] J. Given (1989), 343−347; J. Paul, "Jacques Fournier inquisiteur", *CdF* 26/1991, 59.

[8] The edited publication of Fournier's Register in Latin by Jean Duvernoy was used in this paper: *Le Registre d'inquisition de Jacques Fournier, évêque de Pamiers, 1318–1325: manuscrit Vat. latin n^{o} 4030 de la Bibliothèque vaticane, par J. Duvernoy*, Toulouse 3/1965(in ft.: Fournier), whilst the years follow our contemporary calendar, as dated in the French translation of the Register, as this is the common practice.

giving them directions, performing actions that meant becoming a Cathar, or as they called themselves "Ggood Men" (and women).

It is with Fournier's inquisitorial practice that a change in the construction of a heretic was noticed. Deponents mentioned in the *Register* were required to confess their heresy or that of anyone they might have known. John Arnold states that by confessing to the heresy, the accused were called upon to confess other types of transgressions, such as those that could have been considered as sexual and gender deviations. While discussing about the construction of the *confessing subject*, Arnold further stresses that the deponents were not only confessing to heresy, their own or someone else's, but also "sexual subjects, gender subjects, social subject," etc.[9] I would add to this study of the literary construction of the object, which is based on Michel Foucault's idea, that both sexual and elements of social order were in practice a part of the religious state of affairs, and as such were frequently regulated by ecclesiastical institutions. Thus, Arnold's confessing subject cannot be completely separated from the sexual and social subject, since sexual and social elements found their place in Cathar teachings, as well as in the teachings of other religious movements that clashed with the orthodox ecclesiastical ideas. In other words, Cathar theological dogma was not the only element of heresy that the official church wanted to destroy.

3.1. Raymond de Laburat of Quié

Raymond de Laburat was brought to inquisitor Fournier in February 1323, when he confessed. Raymond's confession was heard because according to several testimonies Raymond spoke against the authority of the Church. Namely, the previous year Raymond was reported to the Inquisition by his namesake from the same region, Raymond Peyre. According to his statement, the accused spoke with several other men at the main place in Quié about the fact that several people from their region of Sabarthè were excommunicated because they had not paid the church tax. Supposedly, de Laburat stated: "we made churches for the churchmen and the church doors and now the same priests close the church door in front of our eyes... I wish there were a box in the fields and that the mass is celebrated on it, if thus was done, the priests could not close the doors in front of us, but we could hear it and see it". Raymond's monologue consisted of several more statements that offended the Church. Raymond believed that Fournier had no right to order the inhabitants of Quié to make an Easter candle of a certain weight, that he wished there were no clergy in the Sabarthè except one to hold the imagined mass in the fields, and

[9] J. Arnold, *Inquisition and Power*, Philadelphia 2001, 12−13.

that he wished the clergy to be ordered to work in the fields or to fight against the Saracens.[10]

Raymond's anger should be understood in an individual context and of social relations. Regarding the former, Raymond's fury at the church stems from the fact that he, along with several other people from the area, had been excommunicated due to non-payment of the church tithe, at Fournier's order. Raymond was angry at Fournier because he saw the bishop as the perpetrator of the changes in the social relations, maintained over decades if not centuries in this distant part of France. Raymond believed that the locals did not need to make the Easter candle because it had not been the custom before. It had also not been the custom that those excommunicated were forbidden from attending mass – this was a new custom introduced by Fournier.[11] Seen from this aspect, his clash was not with a single man, who was the most efficient inquisitor of the time, but with the institution of the Church.

Raymond believed that the sinners were the churchmen because they sought to alter the old customs, which gave a type of security to the local shepherd population; they did not feel secure anymore since they could not behave according to the known rules. Fournier, as a member of the system of the inquisition, did not want them to perform according to the identified behaviour, which gave them a certain advantage. In this way, Fournier changed the rules of the game, or even canceled them and compelled the inhabitants to obey the strange principals, which seemed unregulated.

Raymond wished that he were with Fournier in a mountain gorge, known to him and the local inhabitants, where the two of them "would fight out the matter of *carnalges* [a measure of sheep meat that was given to the church], because I would see what the mentioned bishop has in his stomach".[12] An imagined fight, as simple as the shepherd from the Pyrenees, would have maintained the old customs by the simple physical force, but the decentralized countryside with its ancient habits could not have resisted the change led by the larger world, which was irreversibly rushed towards centralization.

The commentaries of Raymond's case mention frequently that the shepherd desired a change in tripartite model of the feudal society, and which they see in Raymond's wish that the second estate – the church and the clergy – disappear from region. I believe that the matter concerns the wish to keep the existing local social order, to which changes, similar to modernization, have been made rapidly.

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[10] J. Fournier, II, 305−29, 305, 308−316; E.Le Roa Ladiri, *Montaju, oksitansko selo 1294−1324*, Novi Sad 1991, 271−2, 307.

[11] *Ibid.*, 310−314, 320.

[12] *Ibid.*, 324.

Raymond defended himself emphasizing that all was said in anger, but the fact that he was one of a few accused who succeeded to draw Bishop Fournier in a debate on ecclesiastical matters testifies to the strength of his belief. For his wishful thinking, which offended the Church, but was far from Cathar theological dogma, Raymond was sentenced to penitence of strict prison, in irons and on bread and water.

3.2. Beatrice de Planissoles

Beatrice's case is one of the most frequently cited from Fournier's Register in studies on Catharism and the inquisition.[13] Beatrice's case can be read as a case of a 'fallen woman', who was sentenced to penitence that was disproportionate to the committed transgression. Beatrice's confession can be taken as a particular erotic story, providing extremely detailed descriptions of her sexual practices and intimate life. Having been accused of saying that if the body of Christ (*hostia*) was as a big as a local mountain, it would have been eaten by then. Beatrice was cited before Fournier in June 1320. According to the Register, Beatrice was born in a family of lower nobility, of a father, who according to Fournier's accusations, was a follower of the Cathar teaching. Whilst married to her first husband, the castellan of Montaillou, she was unsuccessfully wooed by Raymond Roussel, her husband's steward. Roussel attempted to convince her to run away to him to Lombardy, where the Cathars still existed. Afterwards, whilst her first husband was alive, Beatrice was raped by Raymond Clergue, who kept "her publicly as his mistress". Not long after, she was seduced by Raymond's cousin, priest Pierre Clergue. The affair lasted for two years, when she married her second husband. After the death of the second husband, Beatrice started an affair with a priest, Bartholomew Amilhac, her daughters' teacher.[14]

Beatrice's confession demonstrates that her contact with heretical ideas was limited. Raymond Roussel urged her to leave her family behind, to devote herself to God (as understood in the heretical teachings) and go with him to Lombardy. Since she feared for her reputation, Beatrice refused.[15] Pierre Clergue was another man who tried to impose the ideas upon her, which contained elements of the Cathar dogma. Clergue told her that it was irrelevant which men she had sexual relations with, that marriage meant nothing, and even that incest could be justified in certain cases,[16] and when she fell gravely ill, during her second marriage,

[13] Example: E.Griffe, 281; E.Le Roa Ladiri, 172−180, 184−188, 189; J. Arnold, (2001), 197−214.

[14] J. Fournier, I, 218−222.

[15] *Ibid.*, 219.

[16] *Ibid.*, 224, 225.

Clergue urged her to allow the Cathar *prefect* to administer *consolamentum*.[17]

Beatrice's confession can be interpreted in the context of the social norms of Languedoc, which were not innately influenced by Catharism, but which demonstrated influences of local pagan customs. This is the case with a piece of cloth drenched in the blood of Beatrice's daughter's first menstrual cycle, which was found on her when she was arrested, as well as the case with a herb that Pierre Clergue used to place on her stomach during their intercourse, in order to prevent her from conceiving. [18]

We shall never know whether Bishop Fournier was aware that hers was the case of a sinful woman, or he truly believed that she was a member of the Cathar movement. In any case, Fournier asked her specific questions that allowed him to connect her behaviour to the Cathar theological doctrine. Jean Duvernoy believes that Fournier's treatment of Beatrice demonstrates the intention of the Catholic Church to do away with social elements that were considered the centers of the local power.[19] The penitence prescribed for the sins committed was carrying of crosses, whilst her young lover, the priest Amilhac was sentenced only to the recompensation of his sins.

3.3. Arnaud de Verniolle

The third is the case of a young sub-deacon, Arnaud de Verniolle, who was tried for heresy and sodomy. His case is mentioned in several types of medieval studies: from ones related to Cathar society and religion, to those that analyse medieval concepts of gender and sexuality.[20] John Arnold also analyses his case in light of different contexts of the concept of sodomy between the inquisition and the accused in the medieval milieu.

Arnaud's case commences with the accusation by a student that Arnaud offered to hear his confession, although it was not in his jurisdiction, given his low status in the church hierarchy. Several days later three other students confirmed the original accusation. Arnaud was brought to Fournier, where he confessed that he impersonated a priest in order to hear students' confessions, as well as to sodomy. Arno's statement is filled with his personal understanding of what could be most widely defined as his concept of sodomy and most narrowly the act of sodomy. These can be seen from detailed descriptions of sexual acts with men, including the ones he carried out with the mentioned students, as well as

[17] *Ibid.*, 239, 234, 253−4.

[18] *Ibid.*, 252, 248, 244.

[19] J. Duvernoy (1985), 35.

[20] J. Paul, 26, 63.

from the description of the process of seduction.[21] It can be noticed from the *Register* that Fournier attempted to link Arnaud's confession about the homoerotic actions and his understanding of sexual practices, to the Cathar teachings about sexuality and marriage. Thus, Fournier asks Arnaud if he told someone or believed that, since nature ordered him to quench his lust with either a man or a woman, it was not sinful to have relations with men or women.[22] In a sense Arnaud's justification and explanation of his homoerotic practices was deemed heretical.

Arno was sentenced to a year in jail, after which he gave his complete statement with his sentence changed to life in prison and the removal of his ecclesiastical status.

Different opinions exist in historical analysis whether Arnaud was sentenced for heresy or for sodomy. The fact remains that his sentence was too high for the committed transgression. However, as it has been noticed, Fournier's sentences were not calculated based on the weight of the offense. If he managed to establish the existence of heresy, as constructed by him, and managed to bring the accused to confess, the leanest guaranteed penalty was wearing the crosses. Jacques Paul noted rightly that Fournier's penalties were far more severe than those passed by Bernard Gui in Carcassonne.[23] The harshness of the punishments and the changes in the inquisition, which were incomprehensible to the locals, are not only a historical construction but were noted by contemporaries.

It seems that Arnaud did not comprehend that the rules of inquiry changed with Fournier, since throughout the process he was defending himself from the charges of sodomy, continuously referring to the consensual nature of the sexual relations that he pursued with the other men from his statement.[24] In that Arnaud's reaction is similar to Beatrice's, who defended her honour rather than herself from the heretical ideas, and Raymond, who attempted to prove to the inquisitor that he had issues with the changes in social customs rather than spiritual dogma. Raymond was convicted for wishful thinking and not for the crime of heresy. Their mistake was that their quarrel was not with one man, but with the system that was becoming more rigid and which was being born together with a more centralized authority.

The earlier *Manuals* for inquisitors contained specific questions, which the accused had to answer. These were related to actions and the terminology used by *perfecti* and the contacts that the accused had with members of heretical sects. Fournier asked the accused to confess, which

[21] J. Fournier, III, 14−50.

[22] *Ibid.,* 49.

[23] J. Paul, 62.

[24] J. Fournier, III, 39.

meant talking about themselves and their pasts,[25] which always contained an element of sin as misbehaviour, which allowed him to add to the actions deemed heretical, to the extent that thoughts became a regulated area. It is within this gap between the old judicial system and the new, more complex system of the inquisition that the surprise of those convicted needs to be viewed. When one prisoner heard that an inmate had been punished only for what the former thought had been said in anger, he exclaimed that he had never heard that the inquisitor at Carcassonne (unlike Fournier in Pamiers) condemned anyone for words said if those had not seen the heretics.[26] Fournier's contemporary's opinion stands in contrast to that of a famous historian of Catharism, Elli Griffe, who believes that Fournier's sentences might have been harsh, but were in line with the spirit of the time.[27] Some contemporary members of the clergy believed the trials to be both unfair and staged, to such an extent that even Peter and Paul would have been condemned.[28] As Irene Bueno noticed, Fournier's inquisitorial way meant a clean cut from previous practices, where dogma played a small role and the official respect of the sacrament represented the distinction between heresy and orthodoxy. He sought to extend heretical paradigm, by introducing new elements that were followed in the courts as wrongdoings.[29] Such an inquisitorial manner was made possible by the lack of sense of guilt – the intention to for commit delict was no element of guilt.[30] The cultural difference between Fournier, the doctor of theology from the Paris University, and inhabitants of the Pyrenees is undeniable.

3. CONCLUSION

The absence of an organized heretical movement in Languedoc led Fournier to prosecute acts that had not been considered characteristically heretical. Transgressions were linked to elements of Cathar teachings, whose ideas of sexual freedom of both sexes and non-acceptance of marriage were known to the inquisitors. This enabled construction of a heretical identity from the offending identity. Through this processes the French inquisition isolated behaviours and contextualized them as dan-

[25] John H. Arnold emphasizes this in definition of the confession and employs it in when talking of the construction of the confessional subject.

[26] J. Duvernoy (1985), 47.

[27] E. Griffe, 281−283.

[28] A. Friedlander, *The Hammer of the Inquisitors,* Leiden 1999, 49; J.Arnold, "Inquisition, Texts and Discourse", *Texts and the Repression of Medieval Heresy* (eds. C. Bruschi, P. Biller)*,* New York 2003, 64.

[29] I. Bueno, *Defining Heresy Inquisition, Theology, and Papal Policy in the Time of Jacques Fournier*, Leiden 2015, 112, 119.

[30] J. Duvernoy (1985), 47.

gerous, deviant, 'other', i.e. heretical, and managed to have a positive influence in the process of very early centralization of France. Fournier succeeded in creating a judicial court system that was almost impossible to leave the accused unpunished, i.e. they had to repent their sins, thus becoming a member of marked sub-group.

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WHY DO BORROWERS CHOOSE SUBOPTIMAL MORTGAGE CONTRACTS? A BEHAVIORAL ECONOMICS APPROACH

Mortgage contracts have evolved to include a variety of contract design features whose aim is to address the demand of heterogeneous borrowers. Given that borrowers know best their budget constraints and preferences for risk exposure, the question is why many borrowers fail to maximize their welfare through the choice of mortgage contract. The aim of this paper is to explain the causes of suboptimal outcomes in the mortgage market, relying on the theoretical framework of behavioral economics. The first part of the paper provides an overview of the main differences between the rational choice and behavioral economics approach to contract efficiency and discusses the most relevant cognitive biases, identified within behavioral economics. The second part of the paper applies the findings of the two approaches to the issue of mortgage contracts. Considerable attention is devoted to contract design features that are expected to exacerbate the borrower's cognitive biases. Finally, the paper addresses the issue of why market forces fail to "debias" borrowers and, hence, eliminate inefficient mortgage terms.

Key words: *Behavioral law and economics. – Mortgage contracts. – Contract efficiency. – Cognitive biases.*

1. INTRODUCTION

A decision to buy a real estate and to finance it through a residential mortgage loan (hereafter: mortgage) stands out as one of the most important financial decisions in an individual's life. The obligation aris-

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ing from the mortgage contract to repay the principal and pay the interest usually spans a period of twenty or thirty years. By the very definition of the mortgage, the asset purchased by the loan is used as collateral in the event that the borrower defaults on the loan. Some legal systems make a distinction between a loan agreement, which stipulates the obligations of the parties to a loan contract, and a mortgage agreement, which creates a lien on the property used as collateral. For the purpose of this paper, the term mortgage contract will be used to encompass all the rights and obligations arising from both types of contractual relationships.[1]

Given the long-term horizon and severity of the consequences of defaulting, the parties to a mortgage contract have an incentive to adhere to the contract terms that maximize their expected welfare. This implies that their choice of contract clauses is superior to other available alternatives, as well as that the very decision to enter into a mortgage contract was justified from an ex ante perspective. Yet, one can observe that rather frequently borrowers fail to enhance their welfare through the choice of mortgage terms.[2] Consequently, the question arises as to what explains the persistence of inefficient contract clauses in the mortgage market, and why market forces fail to eliminate them. The aim of the paper is to analyze these issues within the framework of rational choice theory and a behavioral economics approach to law.

The remainder of the paper proceeds as follows. Section 2 briefly introduces the rational choice approach to the contract efficiency. Section 3 provides some background on the main principles of behavioral economics and reviews most important cognitive biases. Once the major concepts in relation to contract efficiency have been introduced, the paper turns to the issue of mortgage contracts. Section 4 discusses the application of the rational choice approach to the issue of the efficiency of mortgage terms. Section 5 examines the efficiency of mortgage contracts from a behavioral law and economics perspective, in particular addressing the complexity of the cost structure, biased risk assessment, and deferred costs. Section 6 examines why market forces fail to "debias" borrowers and eliminate inefficient contract terms. Section 7 concludes the paper.

2. RATIONAL CHOICE APPROACH TO CONTRACT EFFICIENCY

Economic analysis of law has been dominated for decades by rational choice theory. This theory predicts that in competitive markets with

[1] A recourse loan, adopted in civil law countries, also entails that the lender is able to seize the borrower's assets that were not assigned as collateral.

[2] As the 2008 financial crisis has shown, mortgage market outcomes can also have spillover effects on the economy as a whole.

complete information, parties to the contract choose a contractual design that maximizes their joint welfare.[3] Maximization of joint welfare implies that the chosen contractual features ensure the greatest difference between the utility one contractual party derives from the consumption of goods and services and the costs the other party incurs to produce them.[4] Certain contractual terms will prevail if one party can offer such terms at a cost that is lower than what the other party is willing to pay for such terms.

Efficiency predictions rely on an assumption that people are rational decision-makers. This implies that, given the autonomy of will, they will enter into a transaction only if the total benefits exceed the costs. Moreover, rational behavior implies that people are always able to "rank available alternatives according to the extent that they give them what they want"[5], whereas in the context of contracts such alternatives stem from different contract design features. While the rationality assumption seems self-evident in simple transactions, the complexity of contracting requires that individuals are able to process the available information in a fast and correct manner. If the transaction involves uncertainty about future events, which can affect the costs and benefits of contract compliance, rational parties are able to estimate the probability of the outcomes and take them into consideration ex ante at the time of the conclusion of the contract. In other words, parties are able to assess the expected utility stemming from the contract, which is the reason why rational choice theory is often associated with expected utility theory.[6] The ability to assign a probability to different outcomes should hold true independently of whether they are endogenous or exogenous, although this

[3] Joint welfare (surplus) "is computed as the difference between the buyer's willingness to pay and the seller's willingness to accept." F. Parisi, *The language of law and economics: a dictionary*, Cambridge University Press, Cambridge 2013, 42. The rational choice theory also predicts deviations from socially optimal outcomes in the presence of market failures, which will be partially addressed in this paper.

[4] Such outcomes are deemed efficient according to the Kaldor Hicks criterion. Under certain conditions, they are also Pareto optimal. Economic analysis of law that focuses on the efficiency of rules is not preoccupied with distributional concerns as to how the surplus is divided between the parties. However, it has been shown that, under certain conditions, efficient contractual features will be aligned with buyers' interests since sellers will pass on their benefits to buyers in the form of lower prices. For a discussion on the convergence of efficiency and distribution concerns see: R. Craswell, "Passing on the costs of legal rules: Efficiency and distribution in buyer-seller relationships", *Stanford Law Review* 43/1991.

[5] R. Cooter, T. Ulen, *Law and Economics*, Addison-Wesley, Boston-Columbus 2016[6], 13.

[6] The rational choice theory evolved over time to encompass several versions, inter alia, most well-known expected utility theory. For a discussion see: R. B. Korobkin, T. S. Ulen, "Law and behavioral science: Removing the rationality assumption from law and economics", *California Law Review* 88/2000.

distinction will often have an effect on the allocation of risk between parties.[7]

Finally, rational choice theory predicts that people's ranking of available alternatives is consistent over time; they do not experience a conflict between their wants and "shoulds".[8] This implies that the way they choose to trade off benefits in the present against expected benefits in the future is not subject to a change in preferences in the long run.[9]

However, rational choice theory predicts conditions under which efficient contractual terms will not prevail. These conditions involve some of market failures, and two of them play major roles: information asymmetry and transaction costs. Information asymmetry assumes an imbalance of information between the parties to the transaction. If it is severe enough, the problem of adverse selection can impede the exchange.[10] Transaction costs are the costs of an exchange, which encompass "all of the impediments to bargaining".[11] According to the Coase theorem, if transaction costs were zero, private bargaining would ensure efficient contractual terms.[12] Thus, the rational choice approach assumes that a market failure is the only ground on which the law should interfere with the contractual design freely chosen by the parties. Whenever market-based mechanisms are able to attenuate the asymmetry of information or transaction costs, government intervention should be constrained.[13]

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[7] The contract usually stipulates that certain risk will be borne by the party who is better able to prevent, mitigate or bear it. H. Luth, *Behavioural economics in consumer policy: The economic analysis of standard terms in consumer contracts revisited*, Intersentia, Antwerp − Oxford 2010, 136.

[8] M. Statman, *Finance for Normal People: How Investors and Markets Behave*, Oxford University Press, Oxford 2017, 35.

[9] A conflict of a "young self versus an old self" depictures the time inconsistency of preferences. R. A. Posner, "Rational choice, behavioral economics, and the law", *Stanford Law Review* 1551/1998, 1555−1556. Posner opens a discussion on how time-inconsistent preferences can be incorporated into rational choice theory.

[10] This phenomenon is known as "market for lemons". See: G. A. Akerlof, "The market for 'lemons': Quality uncertainty and the market mechanism", *The quarterly journal of economics* 84(3)/1970.

[11] R. Cooter, T. Ulen, 85.

[12] The major implication of the Coase theorem is that, in the absence of transaction costs, the market will ensure efficient outcomes independently of the initial allocation of rights. See: R. H. Coase, "The problem of social cost", *The Journal of Law and Economics* 56(4)/2013.

[13] Government intervention should not go beyond what is necessary to "simplify the task of receiving and understanding information". H. Luth, 27.

3. BEHAVIORAL ECONOMICS APPROACH TO CONTRACT EFFICIENCY

Recent developments of economic analysis of law have been motivated by insights from behavioral economics, which denotes a departure from the rationality assumption. Drawing on the findings of various fields of psychology, behavioral economics calls into question the idea that people are always able to choose the best means to their ends, even if information about alternatives is readily available or obtainable at low cost. Instead, behaviorists assert that individuals are boundedly rational – their brains are not always able to "process a huge amount of information quickly and correctly".[14] Their limited capacities of computation and understanding induce cognitive errors that lead them to choices that are not welfare-enhancing. In the context of contracting, cognitive errors translate into contract clauses that would not have been chosen had individuals processed all the available information. Cognitive errors have been associated with the use of the intuitive system in our brains, which relies on cognitive shortcuts. As opposed to the reflective system, which is slow and effortful, the intuitive system allows individuals to make decisions when faced with an information overload, by decreasing the number of attributes that are taken into account.[15] Simply put, individuals "answer a hard question by substituting an easier one".[16]

It is important to emphasize that rational choice theory does not predict that the choices of each and every individual are always aligned with welfare maximizing predictions. However, deviations from rational

[14] M. Statman, 9. The concept of bounded rationality was introduced by Herbert Simon in 1957. See H. A. Simon, *Models of Man Social and Rational, Mathematical Essays on Rational Human Behavior in a Social Setting*, Wiley, New York 1957.

[15] The distinction between the intuitive and the reflective system was introduced by Keith Stanovich and Richard West. See: K. E. Stanovich, R. F. West, "Individual differences in reasoning: Implications for the rationality debate?" *Behavioral and brain sciences* 23/2000.

[16] C. Jolls, "Behavioral law and economics", *National Bureau of Economic Research*, *w12879/2007, http://www.nber.org/papers/w12879*, last visited 30 August 2017, 12. The use of cognitive shortcuts is not necessarily faulty when overlooked attributes are of negligible importance for the final outcome in comparison with costs of additional effort. However, they turn into errors if individuals disregard or misinterpret important aspects merely because they find a fast answer due to the intuitive system. It has been shown that the level of education and sometimes context-specific knowledge play an important role in deciding when is optimal to substitute the intuitive system with the reflective system. In the context of financial decisions see for example: S. Agarwal, M. Bhashkar, "Cognitive abilities and household financial decision making", *American Economic Journal: Applied Economics*, 5(1)/2013; S. E., Woodward, "Consumer confusion in the mortgage market", 2003, *http://ssrn.com/abstract=2049629*, last visited 10 September 2017; A. Lusardi, P. Tufano, "Debt literacy, financial experiences, and overindebtedness", *Journal of Pension Economics & Finance* 14(4)/2015.

behavior are deemed random and they cancel each other out so that the mean or the average of the distribution of individual behaviors is welfare-enhancing.[17] In contrast, behavioral economics stresses that deviations from rational predictions are systematic and it attempts to explain their different causes. Deviations from rational behavior are commonly known as biases. The paper will only discuss biases that are relevant to mortgage contracts without the intention of providing a comprehensive overview.

As cognitive shortcuts involve focusing on a limited number of attributes that are perceived as particularly important, the question is whether the chosen attributes are indeed the most relevant for a welfare-maximizing decision. It has been shown that their attractiveness to the decision-maker varies depending on how they are presented or framed.[18] Highlighting different aspects of a complex phenomenon leads to different choices by individuals. Consequently, the framing bias occurs once individuals erroneously give more weight to certain features of attributes merely because they are made more salient.

Other types of bias are particularly prominent in situations in which an individual is dealing with probabilistic questions.[19] A cognitive bias that has received sustained attention in literature is availability bias – people assess the likelihood of an event based on how easy it is for them to recall such an event from their memory or recent experiences.[20] An event whose instances are easier to recollect is thought to be more likely to occur. However, the easiness of retrieving certain associations also depends, inter alia, on their salience or the familiarity of the context in which they appear. Consequently, availability is not necessarily correlated with the actual likelihood of the outcome, thus leading individuals to erroneous estimations. Availability resembles another common shortcut known as hindsight – people extrapolate past events into future predictions. However, past outcomes are not always reliable predictors of future outcomes. For example, if the outcome had occurred, individuals are prone to overestimate the likelihood of its reappearance in the future, overlooking other factors that might have an effect.[21]

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[17] For a discussion see: R. A. Posner, 1556.

[18] For a detailed discussion of framing phenomenon see: I. P. Levin, S. L. Schneider, G. J. Gaeth, "All frames are not created equal: A typology and critical analysis of framing effects", *Organizational behavior and human decision processes* 76(2)/1998.

[19] A. Tversky, D. Kahneman, "Judgment under Uncertainty: Heuristics and Biases", *Science* 185/1974, 1131.

[20] Probabilistic questions arise when an individual is supposed to evaluate whether certain objects or events belong to a particular class or a process, to estimate the frequency or plausibility of a course of events, or to make certain numerical predictions. A. Tversky, D. Kahneman, 1127−1128.

[21] C. Jolls, 15.

Another cognitive tool used for predicting uncertain future events is anchoring. It is mainly applicable in situations in which individuals are supposed to predict a numerical value. It has been shown that in the early stage of a decision-making process people create a preliminary estimation of an unknown value that serves as a benchmark for their actual prediction, which is subsequently adjusted to a small extent under the influence of additional considerations.[22] Many experiments have demonstrated that such anchors are context-specific while at the same time the subsequent adjustments are insufficient.[23] As a consequence, different anchors yield different final choices. Anchoring is highly relevant once individuals are supposed to assess the likelihood of compound events, which consist of several simple events linked into a conjunctive or a disjunctive structure.[24] The earliest event is a natural benchmark for the predictions of the likelihood of the compound event. It has been shown that anchoring leads to erroneous optimism regarding desirable events, while at the same time it prompts individuals to underestimate risks.[25]

Unwarranted optimism regarding future events is also known as the optimism bias. Optimism bias has been described in literature with respect to the decisions that involve a time dimension i.e. costs and benefits that accrue at different points in time. For the analysis of mortgage contracts, it is important to draw attention to the phenomenon known as present bias or myopia, which means that people tend to give excessively more weight to benefits that materialize in the present, compared to those in the future.[26] Similarly, people typically underestimate the burden of costs that are supposed to be borne in the future.[27] While shortsightedness can be observed through the lens of bounded rationality, it is often associ-

[22] A. Tversky, D. Kahneman, 1128.

[23] In the context of loan terms see for example: C. Dougal, J. Engelberg, C. A. Parsons, E. D. Van Wesep, "Anchoring on credit spreads", *The Journal of Finance* 70(3)/2015.

[24] A conjunctive structure implies that every isolated circumstance or event is a necessary but not sufficient condition for the occurrence of the compound event. Consequently, the probability of the isolated circumstances is higher than the probability of the compound event. Desirable events are usually compound events with a conjunctive structure. In contrast, in a disjunctive structure, the occurrence of any of the isolated circumstances results in the occurrence of the compound event. Thus, the probability of the compound event is higher than the probability of the isolated circumstances. Events that involve risks are typically compound events with a disjunctive structure. A. Tversky, D. Kahneman, 1128−1129.

[25] *Ibid*.

[26] T. O' Donoghue, M. Rabin, "Doing it now or later", *American Economic Review* 89(1)/1999, 103–124.

[27] Since even extremely high interest rates are not able to explain people's shortsightedness in some instances, this phenomenon is also denoted as hyperbolic discounting. This concept was introduced by D. Laibson, "Golden eggs and hyperbolic discounting", *The Quarterly Journal of Economics* 112(2)/1997.

ated with another strand of behavioral economics literature – bounded willpower. This creates the time inconsistency of preferences as "people fail to follow through on the plans they make."[28] They are unwilling to give up something in the present in order to achieve their long-term aims. The hypothesis of bounded willpower was used to reexamine life-cycle theory, which predicts that people optimize their spending and saving behavior during their lifetime to ensure smoothed spending patterns or "permanent income".[29] Behavioral insights, on the other hand, emphasize that people often fail to match their permanent income.[30]

Differences between rational choice theory and behavioral economics have important implications on the discussion concerning the extent to which the interference of legal rules with the parties' autonomy of will is desirable. Since behavioral economics predicts that unregulated market will yield suboptimal outcomes even in the absence of the market failures described by rational choice theory, it calls for legal intervention of much greater scope. Legal rules assume a new role in "debiasing" parties to the contract,[31] by virtually protecting them from their own cognitive errors and weakness of will.

4. MORTGAGE CONTRACTS FROM THE RATIONAL CHOICE PERSPECTIVE

A mortgage contract is a type of a loan agreement in which the obligation of the borrower to repay the principal and pay the interest is secured with collateral of a specified real property purchased with the loan amount. The paper will focus on residential mortgage agreements, which entail that the loan is originated for the purpose of buying a home.[32]

A typical mortgage contract stipulates the amount of principal, the maturity of the loan, repayment details,[33] administrative fees of different sorts, insurance, and other rights and remedies. An inherent characteristic

[28] C. Jolls, 16.

[29] M. Statman, 219.

[30] This is either due to insufficient self-control or because they find it difficult to correctly estimate their wealth, longevity or future consumption needs. M. Statman, 221–227.

[31] C. Jolls, 2.

[32] Although many aspects of the analysis can be generalized to encompass other types of loan contracts, and to a certain extent some consumer contracts, the focus of the paper is motivated by the widespread and significance of residential mortgages and the fact that behavioral traits are expected to be more common among consumers or households as compared to firms.

[33] Repayment details typically include monthly payments, the interest rate, and interest rate adjustment rules.

of a loan contract is that the lender's benefits from the exchange depend on "borrower controlled activities"[34], which is the reason why the contract typically includes various terms that allocate the risks to the borrower.

According to the rational choice approach, the heterogeneity of borrowers with respect to their ability to control and bear certain risks, explains the complexity of the contracts. An array of mortgage contracts reflects the efficiency consideration that people are best off with an abundance of alternatives to choose from. since they know their preferences and constraints. However, this implies that before entering into a mortgage contract the borrower is able to correctly estimate a whole set of contingencies and price them accordingly. Such contingencies usually encompass interest rate risk, inflation risk, foreign currency risk, refinancing options and penalties, prepayment options and penalties, the borrower's constraints today and in the future. The efficient contract terms are not necessarily the most protective vis-a-vis the borrower nor do they allocate most of the risks to the lender. In essence, the efficiency of contract terms depends on whether the borrower is willing to pay a risk premium to alleviate such risks. For efficient contract features to prevail, it is not required that the borrower is effectively able to negotiate every contract clause.[35] Despite the fact that most of the mortgage contracts are standard form contracts, the possibility to shop for different terms offered by competitors is expected to prompt lenders to offer efficient contract design features.[36]

However, rational choice theory allows that, in many instances, borrowers are unwilling to read certain parts of the contract and, consequently, to shop for the best terms.[37] Such behavior can be explained by the positive costs of informing – if the costs of reading, understanding

[34] V. L. Smith, "The borrower-lender relationship", *American Economic Review* 66 (3)/1976, 406.

[35] Individual negotiations are rather rare given the high transaction costs.

[36] A group of "comparison shoppers" is expected to discipline the market. A. Schwartz, L. L. Wilde, "Intervening in markets on the basis of imperfect information: A legal and economic analysis", *U. Pa. L. Rev*. 127/1978, 649. In connection to this, efficiency will not entail that available contract design features are customized to the preferences of all borrowers. Instead, they will reflect the demand of prevalent groups of borrowers. The reason is that "the costs of information, monitoring, negotiating and transacting do not make it worthwhile". For example, interest rates, which incorporate the default risk premium, are not fine-tuned to the default risk of individual borrowers. V. L. Smith, 406.

[37] Some recent papers address this issue empirically. See for example: F. Marotta-Wurgler, "Does Contract Disclosure Matter?", *Journal of Institutional and Theoretical Economics*, 168(1)/2012; Y. Bakos, F. Marotta-Wurgler, D. R Trossen, "Does anyone read the fine print? Consumer attention to standard-form contracts", *The Journal of Legal Studies* 43(1)/2014.

and comparing various contract dimensions are too high compared to the possible benefits of more appealing terms, it is rational for the borrowers to remain ignorant. This is known as rational apathy.[38] It is expected to result in the adverse selection with respect to some contract design features, since the borrowers' rational ignorance incentivizes the lenders to compete on price, thus lowering the protection of borrowers stemming from these features.[39] Yet, there are two important caveats. First, the chosen terms are not necessarily inefficient, because the preferences of the borrowers remain unrevealed. Borrowers' interests can be also served by the low protection or risk-shifting terms, if their willingness to pay for better contract conditions is comparatively low.[40] Second, the phenomenon of rational apathy only applies to those contract clauses that allocate small or remote risks or set fees of negligible importance. Borrowers are expected to shop for clauses whose content substantially contributes to the financial burden stemming from the mortgage contract, such as the interest rate clause. In such cases, the benefits of shopping for better terms are higher than the costs of becoming well informed. As a consequence, lenders offer efficient terms.

5. MORTGAGE CONTRACTS FROM THE BEHAVIORAL ECONOMICS PERSPECTIVE

In contrast to the rational choice approach, behavioral economics asserts that contract inefficiency can emerge even if the net benefits of becoming acquainted with the meaning and consequences of contract terms are positive. This is when the theory of imperfect rationality steps in to complement the theory of imperfect information.[41] Inefficiency is the result of biased perceptions, which cause borrowers to underestimate the true cost of the mortgage contract. Alternatively, borrowers overestimate their ability to repay the loan in the long run.[42] The question is what

[38] M. G. Faure, H. A. Luth, "Behavioural economics in unfair contract terms", *Journal of Consumer Policy* 34(3)/2011, 340.

[39] The market for contract design has been compared to a "flea market", in which one party to the contract is offered low prices, but can only get a minimum of rights with respect to the other party. Schäfer, H. B., Leyens, P. C, "Judicial Control of Standard Terms and European Private Law–A Law & Economics Perspective on the Draft Common Frame of Reference for a European Private Law", 2009, *http://ssrn.com/abstract=1520457*, last visited 25 September 2017, 107.

[40] Transaction costs reduction due to the absence of shopping for terms should also be taken into consideration when assessing the efficiency of terms.

[41] O. Bar-Gill, "The law, economics and psychology of subprime mortgage contracts", *Cornell L. Rev* 94/2008, 1127.

[42] The inefficiency of mortgage contracts emerges either because borrowers would not enter into the loan contract in the first place or would opt for a different set of contract terms if they were able to correctly assess the expected net benefits.

kind of mortgage contract clauses prompt borrowers to miscalculate the expected value of the contract and how they relate to the biases and the bounded willpower identified within behavioral economics.

The first source of inefficiency of mortgage contracts lies within their complexity and multidimensionality. For efficient conditions to prevail, borrowers have to be able to properly estimate many price dimensions and to aggregate them into a true cost of borrowing. This cost mainly depends on two distinct elements: fees and interest.[43] The difficulty of assessing the total cost of a loan is aggravated by the fact that different price dimensions are contingent on future circumstances, some of which are exogenous for both sides. Once uncertainty is involved, borrowers are expected to calculate the compound expected value, which implies that each price component is multiplied by the expected probability of the outcome.[44] Since such an analysis is computationally exhaustive, information overload induces borrowers to rely on cognitive shortcuts that reduce the number of attributes and price components being considered. Cognitive shortcuts used in such circumstances can be qualified as framing, in line with behavioral economics terminology. Framing does not imply that the borrowers' choice of contract dimensions is completely random. Instead, they are prone to focus on features that they perceive more salient. There are two important implications of framing based on saliency. First, market forces are expected to achieve efficiency only with respect to salient contract attributes and price components.[45] Non-salient terms are expected to go unnoticed, thus reducing lenders' incentives to compete on them.[46] Second, lenders have incentives to shroud some price terms and other important contract attributes that prompt borrowers to underappreciate the total expected cost of the mortgage.[47] Since the underestimated cost of the mortgage translates into a higher expected value

[43] While the role of fees is to compensate the lender for the costs incurred to originate and service the loan, interest reflects the opportunity cost of capital and compensates the lender for various risks she is exposed to. These risks include default risk, inflation risk, foreign currency risk, and interest rate risk.

[44] In order to compare the cost of different mortgage products, the analysis has to be both "nonselective and compensatory". Non-selective analysis means that the borrower takes into consideration all relevant attributes, whereas compensatory analysis assumes that they are able to trade off desirable contract design features of one mortgage contract against desirable contract design features of another. R. Korobkin, "Bounded rationality, standard form contracts, and unconscionability", *The University of Chicago Law Review* 70/2003, 1219−1291.

[45] *Ibid.*, 1234.

[46] *Ibid*.

[47] For a discussion on when shrouding attributes is an optimal strategy for sellers see: X. Gabaix, D. Laibson, "Shrouded attributes, consumer myopia, and information suppression in competitive markets", *The Quarterly Journal of Economics* 121(2)/2006.

of the contract, it allows for credit expansion among borrowers who would not otherwise enter into a mortgage.[48]

Inefficient mortgage contracts can also appear as the result of bias related to the perception of risks embedded in the contract terms. In principle, the main risk that affects the total cost of a loan is the risk of interest rates changing over the life of the loan.[49] The allocation of interest rates risk can vary from imposing all the risk on the lender in the case of fixed interest rates, to imposing all the risk to the borrower in case of fully adjustable interest rates.[50] In countries in which banks mainly rely on deposits and other borrowings in foreign currency, the total cost of the loan is even more influenced by changes in foreign currency exchange rates. Similarly to adjustable interest rate clause, mortgage contracts often contain a foreign currency clause, which shifts the exchange rate risk to the borrower. Borrowers are sometimes able to choose between several foreign currency clauses, depending on the foreign currency used as a reference for recurring adjustments.[51]

From the outset, a proliferation of different risk-allocation clauses is expected to benefit borrowers, who are able to choose a contract that fits their preferences concerning the degree of risk exposure.[52] However, the inefficiency can result from systematic biases borrowers are prone to when assessing the risk. Biases that lead to underestimation of risks decrease the expected cost of the loan and in turn, increase the expected value of the loan. Several psychological traits identified within behavioral

[48] It is important to emphasize that framing shortcut will turn into a framing error only if, contrary to rational choice predictions, borrowers fail to assume that complex terms and shrouded prices are in fact terms that privilege the borrower and increase the total cost of the loan. "Complexity is attractive to lenders as long as the borrower's approximation is an underestimation." O. Bar-Gill, 1123.

For the empirical evidence that borrowers do not necessarily infer that shrouded prices are high prices in mortgage contracts see: V. Stango, J. Zinman, "Fuzzy math, disclosure regulation, and market outcomes: Evidence from truth-in-lending reform", *The Review of Financial Studies* 24(2)/2011.

[49] Other sorts of risks associated with the stream of payments arising out of the mortgage contract include foreign currency risk and inflation risk.

[50] Accordingly, it is common to denote mortgages as fixed-rate mortgages (FRM) or adjustable-rate mortgages (ARM). Adjustable interest rates assume a periodic adjustment of interest rates in accordance with a specified market index. Recently, there has been a flood of hybrid and more complex interest rate clauses, which entail a fixed interest rate only in the first years of the loan followed by an adjustable interest rate.

[51] In the Central and Eastern Europe countries, borrowers can typically choose between loans indexed in Swiss francs and loans indexed in euros.

[52] For a discussion of factors affecting the choice of interest rate clauses see: J. Sa-Aadu, C. F. Sirmans, "Differentiated contracts, heterogeneous borrowers, and the mortgage choice decision", *Journal of Money, Credit and Banking* 27(2)/1995.

economics make such expectations plausible. The paper will focus on biases peculiar to exchange rate risk.[53]

First, if exchange rates were relatively stable for a significant period preceding the decision to enter into a mortgage contract, borrowers may commit the availability error by failing to retrieve from their memory the existence of less favorable rates.[54] Simply because substantial changes in rates appear remote, they underestimate their variance in the future. Similarly, borrowers commit the hindsight error by extrapolating past exchange rates into future predictions. Since the exchange rates were favorable at the time of the conclusion of the contract, they unreasonably assume that such rates will persist during the life of the loan. Finally, underestimation of risks can be a product of an anchoring error, which entails that people make a preliminary evaluation of an unknown value (future exchange rates) based on idiosyncratic circumstances, and then adjust this value to an insufficient extent in line with other relevant information. One can expect that borrowers use the exchange rate at the time of the origination of the loan as a faulty anchor, which they fail to adjust according to other pertinent factors.[55]

The final source of inefficiencies in mortgage contracts is time-related bias. Mortgage contracts create benefits in the present, while the financial burden is mainly spread over the life of the loan. According to behavioral economics, if individuals are shortsighted and they put excessively more weight on instant gratification as compared to future costs, the financial burden that appeared welfare-maximizing ex ante can lead to welfare loss in the long run. Shortsightedness is reinforced by certain mortgage clauses that defer the stream of payments.[56] Such clauses include low down payments, which translates to increased interest payments in the future, and interest rates clauses that offer a lower rate only during an initial period (escalating payments or teaser rates).[57] Focusing on the short-term dimension of the price of a loan is rational only if bor-

[53] Behavioral economics literature mainly focused on interest rates risk, thus leaving the issue of exchange rate risk in mortgage contracts unaddressed.

[54] Less favorable exchange rates assume that the domestic currency depreciates with respect to the foreign reference currency.

[55] Such factors include the duration of the contract, the historical variance of exchange rates, economic cycles etc. This is in line with the predictions that the probability of disjunctive events, which include multiple alternative triggers, such as the case with factors driving the exchange rates or interest rates, is usually underestimated. Systematic underestimation of risks associated with adjustable interest rates was found in a study: B. Bucks, K. Pence, "Do borrowers know their mortgage terms?", *Journal of Urban Economics* 64(2)/2008.

[56] O. Bar-Gill, 1119−1121.

[57] *Ibid*.

rowers can reasonably expect that their income will rise in the future.[58] An alternative behavioral explanation for what might seem as an unwarranted optimism is the bounded willpower of borrowers.

However, it is important to emphasize that borrowers differ among themselves concerning the level of financial literacy and tendency to make cognitive mistakes.[59] This can explain, in addition to the heterogeneity of preferences, the abundance of mortgage products. If some borrowers are boundedly rational, it is a perfectly rational response of banks to react to the demand by offering suboptimal contract design features.[60]

6. MARKET FORCES AND "DEBIASING" OF BORROWERS

The question is whether market mechanisms are able to correct contract inefficiencies associated with the behavioral traits of borrowers. Demand-side market correction assumes that borrowers are able to overcome their biases when choosing a mortgage contract, either as a consequence of individual learning process or information sharing among different borrowers. The limitation to the individual learning process is that, due to the long duration of the mortgage contracts, they rarely involve a repeated interaction, from which borrowers could gain a valuable experience and prevent errors.[61] Interpersonal learning is expected to be fairly limited as well due to the fact that once borrowers become aware of the mistakes they made at the time of the origination of the loan, market conditions change to such an extent that their experience is not necessarily relevant to other borrowers.[62]

Supply-side market corrections assume that lenders themselves have an incentive to reveal information that enhances borrowers' welfare or to elucidate the misleading offers of their competitors. Theoretically, if dissemination of information is costless for the lender, there are reasons

[58] Alternatively, escalating payments are rational if borrowers correctly predict that their spending on other goods and services will decrease.

[59] S. Agarwal, M. Bhashkar; S. E., Woodward; A. Lusardi, P. Tufano; S. Agarwal, I. Ben-David, V. Yao, "Systematic mistakes in the mortgage market and lack of financial sophistication", *Journal of Financial Economics* 123(1)/ 2017.

[60] Market corrections can theoretically belong to both the demand and supply side of the mortgage market. O. Bar-Gill, 1079.

[61] The possibility to refinance the loan after a drop in interest rates alleviates this limitation, although, it has been demonstrated that the least informed borrowers are the ones that rarely use such an opportunity. See: S. Agarwal, R. J. Rosen, V. W. Yao, "Why do borrowers make mortgage refinancing mistakes?", 2012, *https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2446753*, last visited 8 September 2017.

[62] It is also arguable that borrowers have little incentives to spread their knowledge among other borrowers.

to expect that competitive forces will eliminate contract inefficiencies. Yet, "competitive debiasing" does not occur due to "the debiasing curse", which implies that information revealing harms rather than enhances the welfare of the lender.[63] The debiasing curse emerges when lenders use shrouded attributes (non-salient contract terms) to cross-subsidize the price of salient attributes, and therefore, make their services appear cheaper to borrowers. It is not in the lender's interest to educate borrowers since this would only incentivize borrowers to shop the main service (with salient attributes) from the competitor for a subsidized price, while at the same time avoiding or substituting away from inefficient non-salient terms.[64] However, this finding is based on the assumption that inefficient non-salient terms are avoidable or detachable from other terms of the contract.[65] Finally, long-term reputational concerns can incentivize lenders to offer only efficient terms. However, such incentives are limited by the fact that there are almost no repeated market interactions, whereas the time gap between the origination of the loan and the revelation of inefficiencies is wide enough to alleviate potential harm to the reputation.

7. CONCLUSION

This paper has investigated the question as to why some borrowers fail to maximize their welfare through the choice of mortgage terms, giving rise to contract inefficiency. It has been shown that, from the rational choice perspective, inefficiency is expected to prevail only with respect to contract terms where the costs of reading, interpreting and comparing different alternatives outweigh the potential increase in utility stemming from better terms. Mortgage clauses that substantially affect the financial burden incurred by borrowers, such as foreign currency or interest rate clause, should induce borrowers to compare offers from various lenders, thus incentivizing lenders to provide efficient terms. In contrast, insights from behavioral economics suggest that some borrowers fail to maximize their welfare even if the expected net benefits of becoming informed outweigh the costs, due to cognitive biases that cause borrowers to overestimate the expected value of the loan. The paper has stressed the importance of three mortgage contract attributes that exacerbate borrowers' cognitive biases: the complexity of the cost structure, risk-allocation clauses, and deferred costs. It has contributed to the existing body of lit-

[63] X. Gabaix, D. Laibson, 4.

[64] *Ibid*., 1–7.

[65] Competitive forces are expected to debiases borrowers if salient and nonsalient terms are linked into a contract structure in which specific clauses are not negotiable or their consequences unavoidable.

erature by pointing to behavioral economics rationale as to why borrowers underestimate the risk inherent in foreign currency clauses.

The contrasting views of rational choice theory and behavioral economics that have been reviewed in the paper have important implications for rethinking the policy approach to mortgage contracts, in particular, risk-allocation clauses. While rational choice insights imply that the law should aim to minimize search costs by compelling lenders to present information in a simple and transparent manner, behavioral economics findings indicate that mere information disclosure rules are not sufficient to eliminate the incidence of cognitive mistakes. Instead, it encourages a more paternalistic approach that entails a deeper interference of the state in parties' autonomy of will. An important caveat to such approach, however, lies in the direct and indirect costs of state intervention, notwithstanding the behavioral traits of the state agents themselves.

The paper has raised two questions in need of further investigation. First, future work should empirically test whether behavioral traits can account for underestimation of risk stemming from foreign currency clause, in line with arguments advanced in the paper. Moreover, it needs to examine whether a more paternalistic policy approach is able to attenuate cognitive biases of borrowers at a comparatively low cost of state intervention.

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INTELLECTUAL PROPERTY RIGHTS AS FOREIGN DIRECT INVESTMENTS: CURRENT STATE OF AFFAIRS IN SERBIA**

This paper deals with the issue of whether intellectual property (IP) rights may be qualified as investments in terms of Serbian laws on investments, bilateral investment treaties (BIT) currently in force, and the ICSID Convention. The author first analyses the provisions of the Law on Investments with a special focus on the provisions defining an investment. By comparing these provisions with the corresponding norms of the previous law, as well as the relevant laws of the countries in the region, the enhanced solutions are highlighted, while the space for further improvement is identified. Subsequently, the author turns his attention to the applicable BITs and the ICSID Convention to examine whether IP rights may represent an investment under their terms. In the case of qualification of IP rights as investments, the right holders could be entitled to rely on the additional standards of legal protection and a new form of dispute settlement mechanism known as investment arbitration, while the host state could be exposed to a greater risk of being declared liable for breaches of legal standards and ordered to pay compensation to the investors. Upon analysing the main practical consequences of the qualification of IP rights, the author critically addresses major principles of the Serbian investment policy, which are identified through a detailed scrutiny of the relevant legal norms.

Key words: *Intellectual property rights. – Foreign direct investments. – Law on investments. – Bilateral investment treaties. – ICSID Convention.*

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"*Economic analysis enables intellectual property law to be grasped as a whole and the many commonalities among the different fields and cases to be seen clearly, along with the significant differences.*"[1]

1. INTRODUCTION

In a globalised world, intellectual property (IP) rights should be strategically important for every market oriented economy. They are globally recognised as valuable assets, significantly contributing to the stock performance, revenue, and the business reputation of any given firm. In line with the state of affairs at the firm level, recent studies in the field of macroeconomics have revealed a noteworthy causal link between legal protection of IP rights, innovation, and economic growth.[2]

Probably the two most important characteristics of today's commerce could be seen in the: "[...] globalisation of economic activities and the expansion of international transactions involving knowledge-intensive products".[3] In other words, commerce relies, to a great extent, on international investment law and intellectual property law, which are almost inseparably intertwined. The functional relationship between these two ubiquitous branches of law might be successfully examined in general terms.[4] Yet, for practical purposes, specific legal rules in the relevant country have to be taken into account.

The legal qualification of IP rights as foreign direct investments (FDIs), under the domestic and international legal framework, might provide IP rights holders with additional legal protection and a new form of a dispute settlement mechanism, known as investment arbitration.[5] Even

[1] R. Posner, W. Landes, *The Economic Structure of Intellectual Property Law*, Harvard University Press, Cambridge, Massachusetts − London 2003, 420.

[2] For further details, see: P. Welfens, *Macro Innovation Dynamics and the Golden Age: New Insights into Schumpeterian Dynamics, Inequality and Economic Growth,* Springer International Publishing, Cham 2017, 16–27, and D. Weil, *Economic Growth*, Pearson Education, Harlow 2013, 226–251.

[3] C. Braga, C. Fink, "The Relationship between Intellectual Property Rights and Foreign Direct Investment"*, Duke Journal of Comparative & International Law* 9/1998, 163.

[4] For further details, see: L. Vanhonnaeker, *Intellectual Property Rights as Foreign Direct Investments – from Collision to Collaboration*, Edward Elgar Publishing, Cheltenham 2015, 9–37.

[5] Investment arbitration is fundamentally different from commercial arbitration. While commercial arbitration is based on an arbitration agreement, investment arbitration may be based on the host state's national investment law, an investment treaty, either multi– or bilateral, or on an investment agreement. In commercial arbitration, the arbitral tribunal judges the contract between the parties, whereas in investment arbitration, the arbitral tribunal makes findings on the host state's behaviour towards a foreign investor.

though this could have several positive consequences for the host state, such as more efficient technology transfer, reduction in IP piracy, and increase in FDI, such guaranteed additional protection could also mean greater exposure of the state in terms of its liability in the event of infringement of the established standards of legal protection. In practical terms, the key question is – can IP rights be qualified as an investment in accordance with the applicable investment law in Serbia, or not? And, if the answer to the first question is affirmative – what could be the main legal consequences and practical problems of such a qualification?

In order to provide answers to the raised questions, this paper will analyse various possibilities of qualifying IP rights as FDI under the Law on Investments (2) and the applicable bilateral investment treaties (BITs) in the Republic of Serbia (3).[6] The qualification in accordance with the ICSID Convention will be examined separately (4),[7] supported by the analysis of the main practical issues that could be noted in the event that IP rights are qualified as investments under the mentioned legal instruments (5). The concluding remarks will follow (6).

2. IP RIGHTS AND THE LAW ON INVESTMENTS

In 2015 the Serbian National Assembly adopted the new Law on Investments, which replaced the previous Law on Foreign Investments.[8] The two main goals of the new Law were to enhance the investment environment in Serbia and to attract FDIs.[9] In order to achieve the promulgated goals, the legislator introduced various forms of additional legal protection and economic incentives for future investors, from national treatment, protection against expropriation and full protection of the rights acquired based on an investment, to state aid and tax relief. Whether IP rights holders might enjoy the supplementary legal protection provided by the new legislation largely, depends on the definition of investment i.e. on the legal qualification of IP rights.[10] In that sense, Article 3 of the Law on Investments introduces the following:

[6] The Law on Investments, *Official Gazette of the RS*, No. 89/2015.

[7] The Convention on the Settlement of Investment Disputes between States and National of other States, Washington DC, 18 March 1965 (hereinafter ICSID Convention).

[8] The Law on Foreign Investments, *Official Gazette of the FRY*, No. 3/2002 and 5/2003, *Official Gazette of the SCG*, No. 1/2003 – Constitutional Charter, and *Official Gazette of the RS*, No. 107/2014 – other law. For further details on the history of investment legislation in the Republic of Serbia, see: V. Pavić, "Odlučnim polukorakom napred – osvrt na Zakon o ulaganjima", *Anali Pravnog fakulteta u Beogradu* 1/2016, 68–83.

[9] See: Article 2 of the The Law on Investments.

[10] Inconsistencies can be identified in the domestic legal system regarding the definition of investment. Namely, the Law on Investment is not the only legal source

"an investment shall be:

[...]

(d) intellectual property rights, protected under the applicable laws in the Republic of Serbia;

[...]"[11]

This part of the definition might be seen as a significant improvement in comparison with the preceding Law on Foreign Investments.[12] The most noticeable improvement may be in the explicit inclusion of IP rights, which better suits the underdeveloped domestic practice and could spare an investor (i.e. IP rights holder) the unnecessary burden of proof and complex legal hermeneutics when it comes to the interpretation of legal norms in a particular dispute. Additionally, the Law on Investments now explicitly provides an investor with the right to transfer incomes and royalties derived from intellectual property rights.[13] However, several shortcomings of the new legislation may be noted as well. To begin with, the Law does not provide any additional requirements for IP right holders, such as transfer of funds or acquisition of IP rights for purposes of performing business activities in the host country, which is the case with real estate property rights.[14] Although the lack of additional requirements might be seen as an enhancement from an investor's standpoint, it could be a shortcoming given that it might allow legal protection to those IP right holders that are not engaged in any investment activity in the host country. A straightforward example to that effect could be found in a case of an author of a movie or any other work of authorship. According to the Law on Copyright and Related Rights, a work of authorship is any author's original intellectual creation, and it is automatically protected by the law without any formal requirements, no matter where it was created.[15] Strictly adhering to the Law on Investments, it could be argued that

containing the definition of investment. However, we find those inconsistencies irrelevant for the legal qualification of IP rights.

[11] Article 3 (2) of The Law on Investments.

[12] The Law on Foreign Investments did not explicitly include IP rights in Article 3, which defined foreign investment. However, the preceding law did not completely exclude IP rights from the scope of legal protection. Article 3 and 6 The Law on Foreign Investments.

[13] The previous Law on Foreign Investments provided "transfer of profit and dividends" acquired based on the investment, but it did not explicitly mention the transfer of royalties or any other incomes from IP rights. See: Article 12 of the The Law on Foreign Investments and Article 9 of the Law on Investments.

[14] Article 3 (2) of the The Law on Investments.

[15] Article 2 and 8 of the The Law on Copyright and Related Rights, *Official Gazette of the RS*, No. 104/2009, 99/2011, 119/2012 and 29/2016 – decision of the Constitutional Court.

any author in the world would be able to enjoy the additional legal protection and initiate legal proceedings against Serbia alleging breaches of the Law on Investments.[16] This issue, of course, is less conspicuous in the context of patents, trademarks, and other industrial property rights, which have to be acquired in a formal procedure before the competent authority. It could be assumed that it is, in fact, those industrial property rights that the legislator had in mind when defining the term *investment*.

Additionally, the Law on Investments provides for a "duty of authorities and urgency in treatment", granting investors "priority right" in front of any Serbian authority (with the exception of the Commission for Protection of Competition) with regard to the decision on any submitted request and issuance of a public document in administrative matters.[17] Even putting aside the meaning of "priority right" in the domestic legal system,[18] this provision could be quite challenging for the Intellectual Property (IP) Office of the Republic of Serbia. Until now, there seems to have been no clear indication that the IP Office regularly performs "priority duty", when it comes to the requests submitted by investors (in terms of the Law). Moreover, it could be disputable how this provision would interact with the provisions of relevant laws regulating acquisition of certain IP rights, which provide a special procedure for submission and decision on submitted requests before the competent authority. Thus, it might be advisable that the IP Office be excluded from the application of this provision together with the competition authority.[19]

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[16] The similar problem of too broad a definition of investment has been identified by domestic scholars with regard to the previous Law on Foreign Investments. See: N. Jovanović, "Pravni režim stranih ulaganja u Srbiju kao banana državu", *Pravo i privreda* 4–6/2013, 455–456; M. Jovanović, *Odgovornost države za zaštitu stranih direktnih ulaganja*, doctoral dissertation, Pravni fakultet Univerziteta u Beogradu, Beograd 2014, 163–164; Almost all of the exposed criticism has been incorporated into the new Law on Investments.

[17] Article 16 of the The Law on Investments.

[18] In the relevant laws dealing with industrial property, priority right is strictly defined and implies a completely deferent meaning. See: Article 89 of The Law on Patents, *Official Gazette of the RS*, No. 99/2011; Article 17 of the The Law on Trademarks, *Official Gazette of the RS*, No. 104/2009 and 10/2013; The Law on Legal Protection of Industrial Design, *Official Gazette of the RS*, No. 45/2015. For further details on the priority right: S. Marković, D. Popović, *Pravo intelektualne svojine*, Pravni fakultet Univerziteta u Beogradu, Beograd 2013, 123–126.

[19] It is interesting that this "urgency clause" makes the Law on Investments unique in the region. The relevant laws in Slovenia, Croatia, Bosnia and Herzegovina, and Montenegro do not contain any similar provisions. See: The Foreign Exchange Act, *Official Gazette of the Sl*, No. 16/2008, 85/2009 and 109/2012; Zakon o poticaju ulaganja, *Official Gazette*, No. 102/2015; Zakon o stranim ulaganjima BIH, *Official Gazette of the FBiH*, No. 61/01 and 77/15; Zakon o stranim investicijama, *Official Gazette of the MNE*, No. 18/2011 and 45/2014;

In addition to the mentioned novelties, the Law on Investments omitted a provision from the previous law providing more favourable treatment.[20] In other words, it does not contain a particular provision for the case when bilateral or multilateral agreements signed by a foreign investor's country and the Republic of Serbia provide more favourable treatment for a foreign investor or its investment in comparison with the domestic law. Yet, this does not necessarily have to be qualified as a shortcoming of the new Law. The legal system should, in any event, be considered as a whole and the provisions of the Law on Investments should be interpreted together with the applicable provisions of bilateral and multilateral investment agreements.[21]

Finally, having in mind the stated goals of the enacted Law, it should be noted that the causal link between a protection of investments and an increase in FDI is strongly affected by the quality of the broader investment environment. IP rights are not a *panacea* and they may strengthen that causal link only to a certain degree, if used and analysed properly. IP rights are: "[...] an important component of the regulatory system, including taxes, investment regulations, production incentives, trade policies, and competition rules. Thus, from a policy perspective, it is the existence of a pro-competitive business environment that matters overall for FDI."[22] Therefore, analysing possibilities of qualifying and protecting IP rights as investments in accordance with the Law on Investments is only one of many missing puzzles. The next two closest puzzles to the explored are: a legal protection of IP rights in accordance with the applicable BITs and the ICSID Convention.

3. IP RIGHTS AND APPLICABLE BITS IN SERBIA

One of the acute problems closely related to the protection and enforcement of IP rights is the *territorial limitation*. Namely, while inventions and other intellectual creations protected by IP rights are easily transferable across borders and continents, IP rights are grounded in the domestic law of the particular state, and their legal effects are mainly limited to the national legal system.[23] This separation between intellectual property rights and objects of protection is of crucial importance for

[20] Article 13 of the Law on Foreign Investments.

[21] This stance is in compliance with the Article 194 of the Constitution of the Republic of Serbia, *Official Gazette of the RS*, No. 98/2006.

[22] E. Maskus, "Intellectual Property Rights and Foreign Direct Investment", *Centre for International Economic Studies*, Working Paper 22/2000, 2–3.

[23] For further details on territorial limitation of IP rights, see: A. von Mühlendahl, D. Stauder, "Territorial Intellectual Property Rights in a Global Economy", *MPI Studies on Intellectual Property, Competition and Tax Law*, Springer, Berlin 6/2009, 653−673.

foreign investors who are willing to commence a business in a given host country. To be more specific, such investors should be very much interested in the scope of legal protection and the effectiveness of legal enforcement in the host country. This might be seen as one of the major reasons why international agreements contain provisions dealing with IP rights.[24]

The potential investor would, in many cases, have a strong incentive to check the possibilities for additional legal protection, which could be provided by BITs. From an investor's standpoint, the main goal of a BITis to provide additional protection and "assure foreign investors of access to an independent international tribunal in the event of a dispute between the host state and the foreign investor".[25] Through the lens of an economist, which usually corresponds with the view of the host country, the main goal and the sole purpose of the BIT is to enhance investment environment and attract FDIs, even though the causal link between BITs and FDIs is quite weak and to a large degree affected by the institutional quality.[26]

As of 2017, Serbia has concluded 54 BITs, while 49 of them are in force.[27] The first huge advantage foreign investors might gain from those

[24] In that sense, the following quote is illustrative: "In order to bridge the gap between territorially limited IP rights and a globally integrated economy, various international treaties have been concluded [...]". J. Hosking, M. Perkams, "The Protection of Intellectual Property Rights Through International Investment Agreements: Only a Romance or True Love?", *Transnational Dispute Management* 2(5)/2009, 3.

[25] S. Subedi, *International Investment Law*, Hart Publishing, Oxford 2008, 55–56.

[26] For further details on the relationship between BIT and FDIs, see: J. Sasse, *An Economic Analysis of Bilateral Investment Treaties*, Springer, Hamburg 2011, 155–177.

[27] Based on the succession rules, the BITs signed by the governments of the former Yugoslavia and the Serbia and Montenegro state union are binding for the Republic of Serbia. The BITs concluded with the following countries are currently in force: Albania (*Official Gazette of the SCG*-MU, No.10/042); Algeria (*Official Gazette of the RS*-MU, No. 05/2012); Austria (*Official Gazette of the FRY*-MU, No.01/02); Azerbaijan (*Official Gazette of the RS*-MU, No.8/11); Belarus (*Official Gazette of the FRY*-MU, No.04/96); Belgium (*Official Gazette of the SCG*– MU, No. 18/04); Bosnia and Herzegovina (*Official Gazette of the FRY*-MU, No. 12/02); Bulgaria (*Official Gazette of the FRY-MU*, No. 04/96); China (*Official Gazette of the FRY*-MU, No. 04/96); Croatia (*Official Gazette of the FRY*-MU, No. 10/01); Cyprus (*Official Gazette of the SCG*-MU, No.14/05); Czech Republic (*Official Gazette of the RS*-MU, No. 10/10); Denmark (*Official Gazette of the RS*-MU, No. 105/09); Egypt (*Official Gazette of the SCG*-MU, No.10/05); Finland (*Official Gazette of the SCG*-MU, No.10/05); France (*Official Gazette of the SFRY*, No.4/1975); Germany (*Official Gazette of the SFRY*, No.7/90); Ghana (*Official Gazette of the FRY-MU*, No. 1/2000); Greece (*Official Gazette of the FRY*-MU, No. 02/98); Guinea (*Official Gazette of the FRY*-MU, No. 02/98); Hungary (*Official Gazette of the SCG*-MU, No.09/2004); India (*Official Gazette of the SCG*-MU, No.23/04); Indonesia (*Official Gazette of the RS*-MU, No.10/11); Iran (*Official Gazette of the SCG*-MU, No.02/05); Israel (*Official Gazette of the SCG*-MU, No.23/04); Kazakhstan (*Official Gazette of the RS*-MU, No. 3/11); DPR Korea (*Official Gazette of the FRY*-MU, No. 01/99); Kuwait (*Official*

treaties is of a substantive legal nature – additional legal protection embodied in various legal standards, which are binding for the host country, such as: fair and equitable treatment, protection against expropriation, national treatment, etc. The second huge advantage is accessibility to additional dispute settlement mechanisms. Namely, the vast majority of applicable BITs provide three forums for the settlement of investment disputes, in addition to the domestic courts. That is also the case with Serbian Model BIT of 2007, which provides *ad hoc* arbitration under the Arbitration Rules of the United Nations Commission on International Trade Law, International Centre for the Settlement of Investment Disputes and the Court of Arbitration of the International Chamber of Commerce as additional forums.[28]

A more detailed analysis of the aforementioned advantages in the context of IP rights legal protection and enforcement will be conducted later in the paper. At this point, it is important to emphasise that in order to be additionally protected, IP rights, in the first place, must be subject to the legal qualification in accordance with the definition of investment, as provided by the applicable BIT. The vast majority of the concluded BITs contain a concise definition of an investment and IP rights are usually explicitly included.[29]

As a starting point in negotiations on a particular BIT, countries are usually inclined to impose provisions from their own Model BIT. In particular, in terms of a qualification of IP rights as the investment, representatives of Serbia could bear in mind a definition provided in Article 1 of the Serbian Model BIT, which reads:

"The term 'investment' shall mean every kind of assets directly invested by an investor of one Contracting Party in the territory of the

Gazette of the SCG-MU, No.2/05); Libya (*Official Gazette of the SCG*-MU, No.10/05); Lithuania (*Official Gazette of the SCG*-MU, No.10/05); Macedonia (*Official Gazette of the FRY*-MU, No. 05/96); Malta (*Official Gazette of the RS*-MU, No. 10/10); Montenegro (*Official Gazette of the RS*-MU, No. 01/10); Netherlands (*Official Gazette of the SRJ*-MU, No. 12/02); Nigeria (*Official Gazette of the FRY*-MU, No. 03/03); Poland (*Official Gazette of the SRJ*-MU, No. 06/96); Portugal (*Official Gazette of the RS*-MU, No. 01/10); Romania (*Official Gazette of the FRY*-MU, No. 04/96); Russia (*Official Gazette of the SRJ*-MU, No. 03/95); Slovenia (*Official Gazette of the SCG*-MU, No. 06/04); Spain (*Official Gazette of the SCG*-MU, No. 03/04); Switzerland (*Official Gazette of the SCG*-MU, No. 03/06); Sweden (*Official Gazette of the SFRJ*, No.12/1979); Turkey (*Official Gazette of the SRJ*-MU, No. 04/01); Ukraine (*Official Gazette of the FRY*-MU, No. 04/01); United Arab Emirates (*Official Gazette of the RS*-MU, No. 1/2015–9); United Kingdom (*Official Gazette of the SCG*-MU, No. 10/04); The list of the applicable BITs is available at: *mtt.gov.rs*, last visited 25 June 2017.

[28] See: Agreement between the Republic of Serbia and _____ on Reciprocal Promotion and Protection of Investments, Article 9, *http://mtt.gov.rs/*, last visited 17 August 2017.

[29] The only exceptions are the BITs concluded with the French Republic and the Kingdom of Sweden, from 1975 and 1979.

other Contracting Party, in accordance with the laws and regulations of the latter and in particular, though not exclusively, shall include:

[...]

d) Intellectual property rights (such as copyrights and related rights, patents, industrial designs, trademarks) as well as goodwill, technical processes and know-how;

[...]".[30]

The Model BIT contains a broad definition of an investment, in terms of IP rights.[31] Similarly to the Law on Investments, the Model BIT imposes no additional requirements for IP rights to be considered as investments, such as: transfer of funds, contribution to the host state development, etc. Moreover, the definition is even broader when compared to the Law since it includes also goodwill, technical processes, and know-how.[32] In relation to those categories, there could, however, be considerable risk that a foreign investor might be faced with *probatio diabolica* to demonstrate in front of a competent authority that its know-how or goodwill has been infringed or jeopardised.[33]

In summary, one might conclude that the Serbian Model BIT provides a definition of an investment (in terms of IP rights) which is too broad. The same conclusion could be reached in relation to the vast majority of the BITs currently in force. The only question that remains is whether extensive legal protection is beneficial for the domestic investment environment. It seems, in this case, that the higher degree of nominal protection does not necessarily improve the effective legal protection. On the contrary, a too broad definition of investment, contained in the applicable BITs, in combination with relatively undeveloped legal practice, might be the cause of legal uncertainty and needless disputes, and might actually discourage investors from investing in the host country.

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[30] Article 1 (2) of the The Serbian Model BIT.

[31] The problem of too broad a definition of investment in BITs has been identified by domestic scholars. See: V. Draškoci, "Problem preširoke definicije pojma investicije u dvostranim sporazumima o međusobnom podsticanju i zaštiti ulaganja između Srbije i stranih država", *Pravo i privreda* 5–8/2007; M. Jovanović, 166–177.

[32] It is interesting that the BIT concluded with Albania, in addition to IP rights and know-how, explicitly qualifies a license as the investment. See: Article 1 (2) (d) of the BIT.

[33] Know-how is not an intellectual property right but the factual relationship. It is the same case with goodwill and technical processes. For further details on delineation between know-how and IP rights, see: S. Marković, D. Popović, 305–309.

4. IP RIGHTS AND THE ICSID CONVENTION

The BITs applicable in Serbia usually provide more than one dispute settlement mechanism. However, the ICSID could be seen as the most common and the only specialised forum in the field of international investment law.[34] That is the primary reason why the legal qualification of IP rights under the ICSID Convention will be analysed separately.

The Republic of Serbia ratified the ICSID Convention in 2007, which is a crucial precondition for an investment dispute to be adjudicated before the ICSID. The additional prerequisites for activation of the dispute resolution mechanism are consent of the parties, the parties' legal status, and a legal nature of a dispute.[35] Following those procedural issues, the tribunal in a particular case needs to closely investigate whether the object of a dispute might be qualified as an investment or, in other words, whether the jurisdiction *ratione materiae* may be established.

The ICSID Convention undoubtedly contains the term *investment*, yet it does not contain the substantial definition of the term.[36] Thus, in legal practice, an economic point of view has been commonly accepted, according to which, an investment might involve five elements: 1) a transfer of funds, 2) a long-term project, 3) a purpose of regular income, 4) a participation of the person transferring funds, and 5) an element of risk.[37] The same stance has been adopted and confirmed in several cases, including *Salini v. Morocco* and *Biwater v. Tanzania*.[38] Based on the Convention's preamble, the *Salini* tribunal has established one additional element that has to be considered – 6) contribution to the host state develop-

[34] One of the main reasons for such a state of affairs may be found in the member states' contractual obligation to implement ICSID awards equally as judgements by their own courts, without any special legal procedure related to the recognition and enforcement of the award. See: Article 54 of the ICSID Convention; for more details on recognition and enforcement of arbitral award see: G. Knežević, V. Pavić, *Arbitraža i ADR*, Pravni fakultet Univerziteta u Beogradu, Beograd 2013, 172–183.

[35] For further details on prerequisites for activation of the dispute resolution mechanism see: M. Stanivuković, "Rešavanje sporova koji proističu iz stranih ulaganja", *Pravni život* 12/97, 229–245.

[36] Article 25 of the ICSID Convention provides the following: "The jurisdiction of the Centre [ICSID] shall extend to any legal dispute arising directly out of an *investment*, between a Contracting State [...] and a national of another Contracting State, which the parties to the dispute consent in writing to submit to the Centre."

[37] See: R. Dolzer, C. Schreuer, *Principles of International Investment Law*, Oxford University Press, Oxford 2012, 60–61; A. Grabowski, "The Definition of Investment under the ICSID Convention: A Defense of Salini", *Chicago Journal of International Law* 15/2014, 287–309; L. Vanhonnaeker, 24–28.

[38] ICSID Case No. ARB/00/4, *Salini et al. v. Kingdom of Morocco*, Decision on Jurisdiction, para. 52; ICSID Case No. ARB/05/22, *Biwater Gauff Ltd. v. United Republic of Tanzania*, Award, para. 316.

ment.[39] Still, it is a prevailing standpoint that the contribution does not have to be measurable and it "should include development of human potential, political and social development, and the protection of the local and the global environment."[40]

Concerning the IP rights, it appears that they could be qualified as an investment under the terms of the Convention.[41] The creation of intellectual goods and subsequent investments in the acquisition of IP rights, their maintenance, licensing and enforcement, are usually not possible without the transfer of funds and long-term performances. Additionally, all the various forms of "IP rights' management" could generate considerable financial risk, especially when it comes to the enforcement. Therefore, these three preconditions (the transfer of funds, long-term performances, and business risk) could be met in a majority of IP rights' cases. The regularity of income might be difficult to satisfy, especially bearing in mind that the value of IP rights depends on many factors, including various conditions in the relevant market.[42] It is not rare that some IP rights simply do not provide the rights holders any income, due to the existence of a better and cheaper products on a relevant market, or simply because of the absence of the initially forecasted demand. Moreover, the regularity of income might, to a certain extent, predetermine fulfillment of the remaining preconditions (the participation in management and the contribution), given that IP rights without market value probably are neither worthy of a substantial commitment, nor contribute to the host state development. However, if the regularity of income is evident, it could be argued that the remaining preconditions are met.

The issue that could be even more challenging is a legal qualification of pre–investment activities as an investment. For instance, in a case when an entity has actively fulfilled all preconditions for creation of a new medicine or a movie in a host country, would it be possible to qualify those pre–investment activities as the investment, in the meaning of Article 25 of the ICSID Convention? If relying solely on existing ICSID case law, the answer would be probably negative. In the *Mihaly v. Sri Lanka* case, the tribunal found that: "The Claimant has not succeeded in furnishing any evidence [...] that pre-investment and development expen-

[39] *Salini et al. v. Morocco*, para. 52.

[40] C. Schreuer *et al*., *The ICSID Convention: A commentary*, Cambridge University Press, Cambridge 2009, 133–134.

[41] The qualification of IP rights under the terms of the ICSID Convention, in accordance with the stances of the established case law, does not prejudice (and should be distinguish from) legal qualification in a particular case.

[42] For further details on the valuation of IP rights, see: L. Russell, G. Smith, *Intellectual Property: Valuation, Exploitation, and Infringement Damages*, Wiley, Hoboken 2005, 140–254; M. Federico, R. Oriani (eds.), *The Economic Valuation of Patents: Methods and Applications*, Edward Elgar Publishing, Cheltenham 2011, 109–205.

ditures in the circumstances of the present case could automatically be admitted as "investment" [...]"[43] Moreover, the negative attitude toward the same question has been taken in the three later cases, *Zhinvali v. Georgia*, *PSEG v. Turkey* and *Generation Ukraine v. Ukraine*.[44] A similar stance has been adopted in legal theory: "[...] pre–investment activities might become a part of the overall investment and thus be protected, only if the project started with realisation."[45] In line with the existing case law and theory, it would be hard to argue that pre–investment activities related to the acquisition of IP rights could be qualified as an investment in accordance with the ICSID Convention. Yet, it seems that those activities might be qualified as part of some other investment, within a project whose implementation has already started.

5. NOTED PRACTICAL ISSUES

Due to the lack of the relevant arbitral practice, it could be difficult to predict all the possible practical consequences of legal qualification of IP rights in accordance with the applicable investment law in Serbia. Yet, some conclusions might be reached from the international arbitral practice, which has already taken the stance that IP rights may be qualified as investments in accordance with the relevant legal instruments.

For example, in the recently concluded case *Fillip Morris v. Uruguay*, the ICSID tribunal qualified trademark as an investment, based on the BIT concluded between the Swiss Confederation and the Oriental Republic of Uruguay.[46] In this case, the Government of Uruguay introduced various regulatory measures affecting the cigarettes market, including those imposing bans on selling different types of presentations of the same brand of cigarettes, advertising, smoking in public places (such as offices, student centres, restaurants, etc.), introducing higher taxes and prescribing mandatory warning images that were to cover at least 80% of the cigarette pack. In such a situation, the legal qualification of IP rights as investments raised the real possibility that the host state could be re-

[43] ICSID Case No. ARB/00/2, *Mihaly International Corporation v. Democratic Socialist Republic of Sri Lanka*, Award, para. 60.

[44] ICSID Case No. ARB/00/1, *Zhinvali Development Ltd. v. Republic of Georgia*, Award, para. 377; ICSID Case No. ARB/02/5, *PSEG v. Turkey*, Decision on Jurisdiction, paras. 66–73; ICSID Case No. ARB/00/9, *Generation Ukraine, Inc. v. Ukraine*, Award, paras. 8.6, 18.5–18.9.

[45] See: C. Schreuer, L. Malintoppi, A. Reinisch and A. Sinclair, 135, 136; R. Hornick, "The Mihaly Arbitration: Pre-Investment Expenditure as a Basis for ICSID Jurisdiction", *Journal of International Arbitration* 2(20)/2003, 189.

[46] See: ICSID Case No.ARB/10/7, *Phillip Morris v. Uruguay*, Decision on Jurisdiction, paras. 183, 234–236.

stricted in amending relevant market regulation and, as a consequence of the introduced regulatory measures, held responsible for causing damages to the IP right holder and obliged to compensate the same.[47]

Additionally, in the *Eli Lilly v. Canada* case, which also appears to be relevant, unsatisfied with the altered legal standards regarding the acquisition of patents in the host state, the claimant commenced the first intellectual property investment dispute under the North America Free Trade Agreement (NAFTA).[48] The claimant argued that the patent protection standards were inconsistent with the same standards of the other NAFTA members and a Canadian patent law at the time when it submitted the patent applications.[49] Under the claimant's case, the rejection of the patent applications amounted to indirect expropriation of its intellectual property rights and contravened its legitimate expectations in relation to its investments in the amount of USD 500 million.[50] This case has also confirmed that the legal qualification of IP rights as an investment could result in the international liability of the host state and compensation of damages caused by the state breaching the standards of legal protection (including expropriation and fair and equitable treatment).

The analysis of investment case law reveals various approaches and different legal standards of protection being claimed by IP right holders in order to protect their investments (IP rights) within international investment law. Fair and equitable treatment, protection against expropriation, national treatment, full protection and security and are just some of the available standards of protection.[51] All these specific standards create different advantages and, at some point, even obstacles for IP rights holders to protect their investments in practice, which makes it even harder to predict all the possible consequences of the legal qualification.

Even though in both the cases analysed above the arbitral tribunals rendered in favour of the host state,[52] the fact that the IP rights could be

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[47] With regard to trademark protection, a similar case was initiated in 2006 when the claimant stated that the BIT was breached and his trademarks expropriated. For further details see: ICSID Case No. ARB/06/14, *Shell v. Nicaragua*; L. Liberti, "Intellectual Property Rights in International Investment Agreements – An Overview", *OECD Working Papers on International Investment* 2010/01, OECD Publishing.

[48] UNCTRAL Case No. UNCT/14/2, *Eli Lilly and Company v. Government of Canada*, Final Award, para. 480; R. Okediji, "Is Intellectual Property Investment? Eli Lilly V. Canada and the International Intellectual Property System", *University of Pennsylvania Journal of International Law* 4(35)/2014.

[49] *Eli Lilly v. Canada,* Notice of Arbitration, para. 9.

[50] *Ibid.*, para. 4.

[51] For further details see: A. Reinisch, *Standards of Protection*, Oxford University Press, New York 2008.

[52] For further details see: *Phillip Morris v. Uruguay*, Award; *Eli Lilly v. Canada*, Award, paras. 478–480.

qualified as an investment represents a starting point for the conclusion that the infringement of such rights might result in the liability of the host state. As the rights holders are now even more encouraged to initiate proceedings against the host states for the alleged breaches of standards of protection, guaranteed by relevant legal instruments, there is an indication that the state could also face several negative impacts stemming from the additional legal protection to IP rights holders, if not in a form of compensation, then at least in the form of an order to bear its own costs of arbitration.[53]

Since the current arbitration practice already expressed the view that IP rights are capable of being expropriated (in terms of relevant standards of protection within the BITs),[54] we could expect further development of arbitral practice in this manner. We could also expect that such a development would raise new questions in terms of interpretation and application of legal standards in the context of IP rights being protected as an investment. That being said, it remains to be seen whether the development of arbitral practice will have any positive impact on the development of the legal framework and investment environment in Serbia.

6. CONCLUDING REMARKS

The Law on Investments has introduced numerous improvements when compared to the preceding Law on Foreign Investments. Explicit inclusion of IP rights in the definition of an investment sends a clear message to all potential investors and enables enhancement of the investment environment. However, the lack of additional requirements such as the transfer of funds, or contribution to the state's development, reveals room for further improvement.

Concerning the definition of investment, the applicable BITs in Serbia mainly contain similar solutions to those envisaged by the Law. Apart from the investors from France and Sweden, all other foreign investors (having the nationality of a country that has concluded a BIT with Serbia) might rely on a broad definition of the term investment, which explicitly includes IP rights. Moreover, some of the BITs in force even refer to goodwill, know-how and technical processes as investments and do not impose any additional requirements.

Unlike the Law and the BITs in force, the ICSID Convention does not explicitly include IP rights in the definition of investment. Still, due

[53] In *Eli Lilly v. Canada* case, the host state had to finally incur part of its own costs of legal representation and assistance. For further details see *Eli Lilly v. Canada*, Award, paras. 474–478.

[54] *Phillip Morris v. Uruguay*, Award, para. 274.

to the established ICSID case law and legal doctrine, it could be concluded that IP rights may be qualified as investments. Nonetheless, the sole existence of such rights would probably not be sufficient to trigger the protection provided by the Convention. By establishing certain additional prerequisites, the case law and jurisprudence have effectively interpreted the definition of investment in a way to protect as investments only those IP rights involving some of the specifically determined forms of economic activity in the host country. Additionally, even if IP rights are qualified as an investment in a particular case, it does not mean that those rights are infringed in terms of the specific standards of legal protection provided by the host state. Consequently, further development of arbitral practice related to the interpretation and application of those legal standards could be of crucial importance for the effective legal protection of IP rights.

The observed discrepancy between nominal and effective legal protection of IP rights is strongly emphasized in Serbia due to the lack of the relevant domestic legal practice and concise legal definitions. The provided broad nominal protection of IP rights could enhance the domestic investment environment, however, at the same time, the lack of any proof of the effective legal protection could lead to deterioration and create a zero-sum game.

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Boris Begović, PhD*

Samuel Bowles, *The Moral Economy: Why Good Incentives Are No Substitute for Good Citizens*, Yale University Press, New Haven & London, 2016, 272

In the very setting of the scene for the book, Bowles sends a clear signal: his aim is to convince a reader that *Homo economicus*, a model of amoral selfishness, is not a prudent assumption on which laws and public policies should be based. It is the incumbent legislative design based on that very assumption that creates incentives to individuals, to direct them towards some desirable behaviour. That is wrong, according to the author, at least in some cases, like examples, frequently and ubiquitously referred to in the book, of parents and their children in Haifa kindergarten and Boston firefighters and their Commissioner. In both cases introduction of (monetary) fines to suppress observed behaviour (late collecting of children and frequent sick leave) produced the opposite results: the intensity of the undesirable behaviour increased. That was apparently sufficient for a bold initial statement by the author: "Economists, who have placed the act of choosing at the center of all human activities, have now discovered, in short, that people are not very good choosers" (p. 8). And all that enlightenment thanks to Thaler, Sunstein, Kahneman, *et al.*, i.e. behavioural economics.

The bottom line, according to Bowles, is that modern legislation is based on the assumption that people are bad, traced back to Hobs and Machiavelli. In the words David Hume, quoted on the front page of the book "every man ought to be supposed to be a *knave* and to have no other end, in his actions, than his private interest". This line of reasoning, amply supported by Oliver Wendell Holmes, means that good legislation is the one made for bad people. Bowles disagrees – he proposes an analytical framework in which the conclusion is that this is not inevitable. The framework is simple: individuals behave according to (external) incentives and (internal) social preferences, i.e. moral norms. The former creates instrumental motives, the latter – intrinsic motives. If the two are

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separable, then good legislation should unconditionally be designed for bad people. Their desirable behaviour would be driven by the law and the incentives that it creates, and desirable behaviour of the good people will be driven by their moral norms. Bad people would not murder anyone because of the expected punishment, i.e. deterrent that it creates, while good people would not kill anyone because of the categorical imperative not to kill. In economics jargon, there is additivity of motives, since they are separable: one works independently of the other, but both work in the same direction.

The analytical problem emerges if they are not separable. In the case of superadditivity, or crowding in (synergy), incentives reinforce moral norms and the joint effect of the two of them is more than just adding the effect of one to the other – obviously not a policy problem. Labour contracts are incomplete, the incentives they create are not perfect for reaching Pareto optimality, but they reinforce work ethics and the outcome is better than just separate effects of incentives and moral norms. According to the author "Moral economy is not an oxymoron" (p. 35). The policy problem, nonetheless, exist in the case of subadditivity, i.e. crowding out (negative synergy) – the case when incentives undermine moral norms. Hence, incentives have countervailing effects in such a situation: the indirect effects of incentives undermine their direct effect. Bowles introduces the notion of strong crowding out, a situation in which the outcome is worse than the situation when incentives are not introduced at all. This is the bottom line of the Haifa case:[1] when a fine was introduced for parents who are late collecting their children, the parents started to collect their children even later than before!

Based on these considerations, a clear analytical framework is introduced with specific best response functions for each case and it is enhanced with the introduction of two types of crowding out. The first one is categorical crowding out, when the sheer presence of the incentives affects a person's social preferences. In other words, in the case of categorical crowding out, the magnitude of the incentive is not relevant. It is the introduction of the fine or subsidy itself that matters for crowding out, rather than their magnitude. The other one is marginal crowding out, in which case the magnitude of the incentive, i.e. its marginal value, is relevant for the outcome;a useful distinction, comparable to the one between fixed and variable/marginal costs. The inevitable conclusion within this analytical framework is that in a situation of categorical crowding out, the incentive should be increased in magnitude to offset the crowding out. Had the fine for parents in Haifa been higher, Bowles concludes, the outcome would have been different: smaller delays, or perhaps no delays at all.

[1] U. Gneezy, A. Rustichini, "Pay Enough or Don't Pay at All", *Quarterly Journal of Economics*, 115(2)/2000, 791−810.

With basic analytics provided, Bowles emphasises that "Learning more about the crowding-out is the next challenge for the Legislator" (p. 56). Perhaps it is so, but nonetheless it does apply only to legislators; in addition to the academic world, it is also about the complex mechanism design in sub-statutory texts, bylaws, contracts, even unwritten rules and any policy, public or not, at any level. "Learning more" is basically about two questions: (1) Does crowding out exist, and how strong/widespread is it? (2) What are the mechanisms of causality from incentives to crowding out?

As to the first question, Bowles' answer is massive referring to various experiments and their results. A substantial number of games specified in game theory have been tested experimentally and the results are reported throughout the book: prisoner's game, public goods game with and without punishment, ultimatum game, dictator game, and trust game. All reported results provide some evidence that behaviour cannot be explained by incentives only – at least the theoretically predicted outcome based on incentives alone is different to the experiment results. Nonetheless, these experiments capture only a small number, a minority of situations in economic life, and it is, at least from the information provided in the book, extremely difficult to estimate the frequency of situations in which incentives do not work properly, i.e. situations in which the outcome is different from the expected. Furthermore, such a discrepancy does not provide evidence that crowding out exists; perhaps it is only evidence of inappropriate incentives mechanism design. Finally, the reader receives no information about the intensity of the crowding out effect even if it exists at all.

Nonetheless, methodologically it is more important whether the results of the human behavioural experiments, a cornerstone of behavioural economics, are reliable, whether these results are a good approximation of real-world behaviour of people. Bowles provides devastating criticism of experimental economics in four points: (1) experimental subjects typically know they are under the researcher's microscope, and they behave differently from how they would under total anonymity or under the scrutiny of neighbours, family or workmates; (2) experimental interactions with other subjects are typically anonymous and lack opportunity for ongoing face-to-face communications, unlike real world interactions; (3) subject pools (to date, overwhelmingly students), may be quite different from other populations, due to their age, process of recruitment and self-selection, creating an unrepresentative sample; (4) social interactions that are studied in experiments are not representative for social relations, since they are focused on settings in which social preferences are important, unlikely many other situations, for example most market transactions. Based on these insights, Bowles concludes that "It is impossible to know

whether these four aspects of behavioral experiments bias the results in ways relevant to the question of separability" (p. 71). It is, nonetheless, puzzling that the author, who subscribes to such scepticism about experimental results, painstakingly uses these results throughout the book as key evidence of the absence of separability, that crowding out exists, and because of that he emphasizes that insight even in the title of the book: "good incentives are no substitute for good citizen".

The second question deals with the mechanism of causality from incentives to social preferences. Bowles identifies two causality mechanisms. The first mechanism is situation-dependence of social preferences. It arises because of heterogeneous repertoire of social preferences of individuals – "our preferences are different when we interact with a domineering supervisor, shop, or relate to our neighbors" (p. 85). The second mechanism is that incentives alter the process in which people acquire social preferences over their lifetime – social preferences are endogenous. Both mechanisms are based on the rather simple insight that incentives, since their purpose is to provide information to the target, inform the target, i.e. agent, about the principal who designed them, about his/her beliefs about agent, about the nature of the task to be done, and, above all, about the presumed motives of the principal who created the incentives. In many cases incentives are "bad news" about the principal – "we are no longerfriends" – changing not only the rules of the game, but its very name. The information incentives inevitably produce moral disengagement or activate control aversion. Furthermore, it can induce a switch in the way of responding to stimulus: affective and deliberative, according to dual process theory, a notion borrowed from psychology. Even, according to the neuroscientific evidence, different regions of the human brain are activated: in the case of incentives – the (deliberative) prefrontal cortex, and otherwise the (affective) limbic system.

Notwithstanding how convincing these findings are, the notion of endogenous social preferences is relevant for examination of the long-term trend of changes of values. Hence the crucial question is not whether incentives sway social preferences, but in what direction. Do market incentives create more or less pro-social values and behaviour? The classical authors disagree on this. For Montesquieu "where there is commerce the ways of men are gentle". For Marx, contrary to that, capitalism and market economy "...is the time of general corruption, of universal venality." Bowles applies a simple reality check – it is evident that the countries where capitalism was born, Western and Northern Europe, are not societies of "universal venality" at all, on the contrary. The problem for the author is that, using his own conceptual framework, there is no other conclusion but that market incentives in the crowding-in process, produced pro-social preferences of the population, and there is ample em-

pirical evidence that preferences are more pro-social in the countries with long capitalist tradition than in other societies. And that conclusion does not speak well about crowding out – which is the major topic of the book. As the antidote to this inevitable conclusion, Bowles suggests a hypothesis about the mechanism the crowding-out effects of market incentives that are offset by institutions of liberal society. Alas, there is no answer to the question why liberal society has been established only in market economies, with all incentives that they provide.

Hence, taking all these things into account, how should legislators behave? After explaining, at least up to a point, a rather nebulous notion of the liberal trilemma (the impossibility of Pareto efficiency, preference neutrality, and voluntary participation), Bowles introducesthe concept of the second-best world. All that is a preparation for the firework of Bowles' own insights that are labelled the "five uncomfortable facts about incentives" that legislators ostensibly learn about after "visits to economics faculties". In his own words: "(1) incentives are essential to a well-governed society; (2) incentives cannot singlehandedly implement a fully efficient use of economic resources if people are entirely self-interested and amoral; (3) ethical and other social preferences are therefore essential; (4) unless designed to at least 'do not harm,' incentives may stand in the way of 'creating better people'; and (5) as a result, public policy must be concerned about the nature of individual preferences and the possibility that incentives may affect them adversely" (p. 185).

This deserves a brief comment: (1) true; (2) not true, see First fundamental theorem of welfare economics, (3) ethical and other social preferences cannot be essential if they do not exist and they do not exist based on the assumption in the previous insight, (4) the possibility exists, no doubt, but one should refer to Montesquieu and empirical confirmation of his prediction about the long-term effects on endogenous social preferences; (5) there is no results whatsoever, or at least it has not been demonstrated in the book, so this normative "fact" about public policy is not relevant. The last point deserves more deliberation. For all the insights in the book, from all the theoretical considerations and experimental results, it is evident that social preferences are relevant in specific situations,which includes personal contact, long term relations, many of them being face-to-face relations. Hence it is about effectiveness of incentives created by contracts, agreements, bylaws, unwritten rules, even one-off orders or guidelines. It is about private, not public policy. It is not about legislators, but about all of us and how we build our social relations. If there is a job for legislators in this area at all, it is to create enough free space for individuals to be engaged in the search of their own optimal mechanism design and to voluntarily conclude contracts that will encompass it. Also, to provide enough legal clout for the *pactasunt-servanda* principle not to be violated.

The book effectively ends with advice for the Aristotelian legislator, the one that will make people better, in ten points (p. 206–7). Some of them are intuitive and reasonable ("in the presence of categorical crowding out, avoid small incentives", "avoid moral disengagement", "avoid control aversion"), but it is questionable how legislator can apply them. Some can be counterproductive – Bowles recommends that legislators should avoid creating "perfect conditions necessary for market to work well in the absence of social preferences". The point is that the market is depersonalised, that social preferences, as Bowles himself explains in his book, are not a salient factor in market transactions, so it is puzzling that the advice to legislators is not to improve conditions for market transaction, not to improve incentives to the exchanging parties to be efficient.

At the end of the day, public policy is inevitably about incentives. Some of them are effective, some are not. Some of them are good, directing individuals towards desirable behaviour, some of them are not. The focus should be to the following question: why are some incentives ineffective and bad? The answer would enable principals to select effective and good incentives. Advances in theory of mechanism design (mainly by 2007 Nobel prize winners Leo Hurwicz, Eric Maskin, and Roger Myerspon) promise that the search for good and effective incentives will have theoretical underpinning, rather than being a purely trial and error process. Bowles' book is a significant contribution to the debate about optimal mechanism design related to incentives. If the book is considered this way, it is a valuable achievement.

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Example: A. Buchanan, "Liberalism and Group Rights", *Essays in Honour of Joel Feinberg* (eds. J. L. Coleman, A. Buchanan), Cambridge University Press, Cambridge 1994, 1–15.

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